86 29 2310

424(a)
33-8853

A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. Information contained herein is subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such State.

PRELIMINARY PROSPECTUS DATED SEPTEMBER 18, 1986

4,500,000 Shares

ATARI®

ATARI CORPORATION

RECD S.E.C.
SEP 25 1986
23

Common Stock

Prior to this offering there has been no public market for the Common Stock. See "Underwriting" for factors considered in determining the initial public offering price, which is anticipated to be between $11.50 and $13.50 per share.

Application will be made to list the Common Stock on the American Stock Exchange.

AN INVESTMENT IN THESE SECURITIES INVOLVES A HIGH DEGREE OF RISK. SEE "RISK FACTORS."

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	*Underwriting Discounts and Commissions (1)*	*Proceeds to Company (2)*
Per Share	$	$	$
Total Minimum	$	$	$
Total Maximum (3)	$	$	$

(1) See "Underwriting."

(2) Before deducting expenses estimated at $, payable by the Company.

(3) Assuming exercise in full of the 30-day option granted by the Company and by certain Contingent Selling Shareholders to the Underwriters to purchase up to an additional 675,000 shares, on the same terms, to cover over-allotments. If the option is exercised in full, in addition to the maximum proceeds to the Company, the Contingent Selling Shareholders will receive $. See "Principal Shareholders" and "Underwriting."

The shares of Common Stock are offered by the several Underwriters, subject to prior sale, when, as and if issued by the Company and accepted by the Underwriters, and subject to their right to reject orders in whole or in part. It is expected that delivery of certificates for the shares will be made in New York City on or about , 1986.

PaineWebber
Incorporated

The date of this Prospectus is , 1986

RECEIVED
SEP 29 1986
Bechtel Information Services
Gaithersburg, Maryland

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by the more detailed information and financial statements appearing elsewhere in this Prospectus. Prospective investors should carefully consider the information set forth under "Risk Factors." Information in this Prospectus has been adjusted to reflect a one-for-two reverse Common Stock split, effective September 12, 1986. Unless otherwise indicated, the information in this Prospectus assumes that the Underwriters' over-allotment option will not be exercised.

The Company

Atari Corporation (the "Company") develops, manufactures and markets microcomputer systems for personal and business use and video game systems, designed to offer advanced technology at low prices. The Company was founded in May 1984 by Jack Tramiel, founder and former Chief Executive Officer of Commodore International Limited. In July 1984, the Company acquired from certain associated entities of Warner Communications, Inc. (collectively referred to as "WCI") certain assets, including 8-bit microcomputer and video game system inventories and the right to use the Atari name and logo, and assumed certain liabilities. See "Business — The WCI Transaction." Substantially all of the Company's revenues from its inception through June 1985 resulted from liquidation of the microcomputer and video game system inventories included in the assets acquired from WCI.

In June 1985 and January 1986 the Company introduced its first 16/32-bit microcomputer systems, the 520ST and the 1040ST. The Company's business strategy is to offer in the ST series advanced microcomputer memory capacity and processing speed technology and to price the ST series as an industry leader based on price-to-memory capacity and price-to-processing speed. The Company believes the 1040ST to be the first microcomputer offering more than one million bytes of internal memory (as much as the Apple Macintosh Plus and more than the standard IBM PC-AT and Commodore Amiga) at a manufacturer's list price of less than $1,000. The Company's ST computers also feature color and high resolution graphics; easy-to-use operating features; and processing speed equalling or exceeding that of any standard 16/32-bit configuration IBM, or any Apple or Commodore microcomputer, as well as those of the Company's other principal competitors, at lower suggested retail prices than these competing products, comparably equipped.

The 520 ST was recently voted "Computer of the Year" by the pan-European computer magazine publishers and "Computer Value of the Year" by *InfoWorld* magazine. As of September 15, 1986, the Company had sold over 150,000 ST computer systems worldwide.

The Company also manufactures and markets 8-bit personal computers and home video game systems. The Company's 65XE and 130XE 8-bit personal computers compete with the Commodore 64 and Apple IIe 8-bit personal computers, for the entry-level computer user, at lower suggested retail prices.

The Company believes that it is the largest seller of video game systems in the United States. Its video game system product line consists of the 2600 VCS and the 7800 ProSystem, which offers enhanced graphics for recently introduced arcade-quality games. Both systems are compatible with an existing video game library of several hundred titles.

Since July 1984, WCI has advanced approximately $24.7 million of working capital to the Company for payment of certain liabilities assumed in the 1984 asset acquisition. Concurrently with the consummation of this offering, the Company will issue to WCI 7.1 million shares of Common Stock and pay to WCI approximately $36.1 million as the purchase price of net assets acquired from WCI and in satisfaction of WCI's working capital loans to the Company and accrued interest. See "Business — The WCI Transaction."

The Company intends to distribute to its shareholders annual reports containing audited consolidated financial statements and quarterly reports containing unaudited consolidated financial information for each of the first three quarters of each fiscal year.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE COMMON STOCK OF THE COMPANY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH TRANSACTIONS MAY BE EFFECTED ON THE AMERICAN STOCK EXCHANGE, IN THE OVER-THE-COUNTER MARKET OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

The Offering

Common Stock offered	4,500,000 shares
Common Stock to be outstanding after the offering	28,262,350 shares
Use of proceeds	To repay indebtedness and to increase working capital.
Proposed American Stock Exchange symbol	ATC

Summary Financial Information
(In thousands, except per share amounts)

	May 17, 1984 (Inception) to Dec. 31, 1984	Year Ended Dec. 31, 1985	Six Months Ended June 30, 1985	Six Months Ended June 30, 1986
Statement of Operations Data:				
Net sales:				
New and redesigned products	$ 16,115	$ 47,817	$ 6,766	$ 89,069
Purchased products	94,565	94,170	40,886	16,517
Total	110,680	141,987	47,652	105,586
Operating income (loss)	(61,455)	(25,819)	(26,336)	16,879
Income (loss) before extraordinary credit	(62,758)	(14,314)	(26,675)	8,467
Net income (loss) (1)	(62,758)	(14,314)	(26,675)	12,400
Per share data (2):				
Income (loss) before extraordinary credit	$ (2.78)	$ (.62)	$ (1.18)	$ .38
Net income (loss) (1)	(2.78)	(.62)	(1.18)	.56
Number of shares used in the computation (2)	22,554	23,033	22,593	23,762

	June 30, 1986	
Balance Sheet Data:	Pro Forma (3)	Pro Forma As Adjusted (3)(4)
Working capital	$ 40,654	
Total assets	134,288	
Long-term obligations including current portion	40,241	
Shareholders' equity	17,175	

(1) Results for the six months ended June 30, 1986 include an extraordinary credit of $3,933,000 ($.18 per share) from the use of net operating loss carryforwards. See Notes 1 and 8 to Financial Statements.

(2) Per share computations for all periods include 7.1 million shares to be issued to WCI concurrently with completion of this offering. Per share computations for the six months ended June 30, 1986 include income before extraordinary credit of $.02 per share and net income of $.04 per share resulting from satisfaction of interest expense related to working capital loans from WCI by issuance of a portion of these shares. See "Business — The WCI Transaction" and Note 1 to Financial Statements.

(3) Reflects partial payment of the purchase price of net assets acquired from WCI and satisfaction of approximately $24.7 million of obligations to WCI and accrued interest by issuance of shares of Common Stock. See "Business — The WCI Transaction" and Notes 2, 5 and 9 to Financial Statements.

(4) Adjusted to reflect the sale by the Company of 4.5 million shares of Common Stock offered hereby and application of the estimated net proceeds from the sale. See "Use of Proceeds" and "Capitalization."

THE COMPANY

Atari Corporation develops, manufactures and markets microcomputer systems for personal and business use and video game systems, designed to offer advanced technology at low prices. The Company was founded in May 1984 by Jack Tramiel, founder and former Chief Executive Officer of Commodore International Limited. In July 1984, the Company acquired from WCI certain assets, including Atari 8-bit microcomputer (models 600XL and 800XL) and video game (models 2600 and 5200) inventories and the right to use the Atari name and logo, and assumed certain liabilities. See "Business — The WCI Transaction." Substantially all the Company's revenues from its inception through June 1985 resulted from its liquidation of the microcomputer and video game system inventories included in the assets acquired from WCI.

In June 1985, the Company introduced the 520ST, its first 16/32-bit microcomputer system, and, in January 1986, it introduced the 1040ST 16/32-bit system. In 1985, the 520 ST was voted "Computer of the Year" by the pan-European computer magazine publishers and "Computer Value of the Year" by *InfoWorld* magazine. As of September 15, 1986, the Company had sold over 150,000 ST systems worldwide.

The Company's business strategy is to offer in the ST series advanced microcomputer memory capacity and processing speed technology and to price the ST series as an industry leader based on price-to-memory capacity and price-to-processing speed. The Company believes the 1040 ST to be the first microcomputer offering more than one million bytes of internal memory (as much as the Apple Macintosh Plus and more than the standard IBM PC-AT and Commodore Amiga), at a manufacturer's list price of less than $1,000. The Company's ST computers also feature color and high resolution graphics; easy-to-use operating features; and processing speed equalling or exceeding that of any standard 16/32-bit configuration IBM, or any Apple or Commodore microcomputer, as well as those of its other principal competitors, at lower suggested retail prices than these competing products, comparably equipped.

Within the next twelve months, the Company intends to introduce additional microcomputer enhancements using the current ST operating system and compatible with current ST applications software, including products offering additional internal memory capacity and substantially enhanced color resolution and spectrum capacity; a dedicated graphics co-processor that will generate graphics at up to five times current speeds; and a UNIX-based multi-user, multi-tasking microcomputer system.

In early 1985, the Company introduced its own 8-bit computer lines targeted for the entry-level computer user: the 65XE, offering 64K of internal memory, and the 130XE, offering 128K of internal memory, at retail prices generally less than $100 and $150, respectively. The 65XE and 130XE are compatible with several hundred software titles written for the 600XL and 800XL computer inventories acquired from WCI.

The Company believes that it is the largest seller of video game systems in the United States. Its video game system line consists of the 2600 VCS and the 7800 ProSystem. The 2600 VCS, a re-engineered and redesigned version of the product inventory acquired from WCI, was introduced in late 1984 and generally retails for less than $50. The Company's 7800 ProSystem, first offered in May 1986, features enhanced graphics for recently introduced arcade-quality video games and generally retails for less than $100. Both video game systems are compatible with an existing library of several hundred video games.

Since July 1984, WCI has advanced approximately $24.7 million of working capital to the Company for payment of certain liabilities assumed by the Company in the 1984 asset acquisition. Concurrently with the consummation of this offering, the Company will issue to WCI 7.1 million shares of Common Stock and pay to WCI approximately $36.1 million (including interest at 17%) as the purchase price of the net assets acquired from WCI in the 1984 transaction and in satisfaction of WCI's subsequent working capital loans to the Company and accrued interest. The Company's 1984 purchase of assets from WCI, the payment of the purchase price and the repayment of working capital loans from WCI are referred to in this Prospectus as the "WCI Transaction." See "Business — The WCI Transaction."

The Company was incorporated in Nevada in May 1984. Its principal executive office is located at 1196 Borregas Avenue, Sunnyvale, California 94088-3427. Its telephone number is (408) 745-2000.

The following trademarks appear in this Prospectus: IBM, IBM PC, IBM PC-XT 286 and IBM PC-AT, owned by International Business Machines Corporation ("IBM"); Apple, Apple IIe, Apple IIgs, Macintosh and Macintosh Plus, owned or licensed by Apple Computer, Inc. ("Apple"); Commodore, Commodore 64 and Commodore Amiga, owned by Commodore International Limited ("Commodore"); Leading Edge Model D, owned by Leading Edge Hardware Products, Inc.; Tandy 1000 EX, owned by Tandy Corporation ("Tandy"); Compaq Deskpro 286, owned by Compaq Computer Corporation ("Compaq"); Kaypro 286i, owned by Kaypro Corporation; GEM, owned by Digital Research, Inc.; Microsoft WRITE, owned by Microsoft Corporation; VIP Professional, owned by VIP Software, Inc.; DB Man, owned by Versasoft Corporation; dBASE III, owned by Ashton-Tate; InfoWorld, owned by C W Communications Inc.; Lotus l-2-3, owned by Lotus Development Corporation: UNIX, owned by Bell Telephone Laboratories, Incorporated; and Atari, 520ST, 1040ST, 65XE, 130XE, 600XL, 800XL, 2600 VCS, and 7800 ProSystem, owned by Atari Corporation.

RISK FACTORS

Prospective investors in the Company should carefully consider, among other things, the following factors regarding the Company and its business:

Industry Trends. Unit sales of personal computers in the United States declined during 1984 from the prior year and grew moderately in 1985. Although moderate unit sales growth has been forecast for 1986, it has been predicted that, as the result of price competition, U.S. dollar sales of personal computers will rise modestly, if at all. It cannot now be determined whether this change is cyclical or evidences a long-term trend toward slower growth in unit and dollar sales of personal computers.

Short Operating History. The Company commenced operations in the second quarter of 1984 and introduced its ST series of computers in June 1985 and January 1986. The Company incurred cumulative losses through December 31, 1985 of $77,072,000. Although the Company reported a profit for the six months ended June 30, 1986, results of the Company's operations for this interim period are not necessarily indicative of the results that might be expected for the entire fiscal year. Operating results for future periods are subject to numerous risks and uncertainties, and there can be no assurance that the Company will achieve continuous profitable operations.

Competition. The personal computer and entertainment electronics industries are intensely competitive and are characterized by constant introduction of new products, rapidly declining prices and advancing technologies. In sales of its microcomputers, the Company competes with larger companies, such as IBM, Apple, Commodore, Tandy and Compaq, that have well established product lines, dealer acceptance, software support and customer loyalty, and materially greater resources than the Company, as well as with numerous other domestic and international distributors of IBM-compatible and other personal computers. The Company's computers do not use the MS-DOS operating system and are therefore not compatible with the IBM PC, which dominates the business market for personal computers. Increased availability of low-priced IBM compatible computers; recent material PC price reductions by IBM; and recently announced new product introductions by IBM, Apple, Tandy and Compaq could force further price reductions for the Company's products and reductions in the Company's profit margins. See "Business — Competition."

Necessity for New Products. Continual technological developments, which make existing computers vulnerable to early obsolescence, and continuing competitive price reductions in the personal computer and entertainment electronics industries will require that the Company create and market new computer and entertainment electronics products at low prices and continue to reduce prices of its existing products. The Company will be required to incur substantial expenditures in research and development of new products before market acceptance of any such products can be assessed. There can be no assurance that such products will achieve market acceptance.

Necessity for Additional Applications Software. Availability of applications software is a material factor in consumer selection among competing microcomputer products. As of September 15, 1986 approximately 300 software products were available for the Company's ST computers from independent vendors in the United States and a similar number were available from developers outside the United States. Most of the Company's major competitors have larger available software libraries. Accordingly, continued third party development of applications software for the Company's computers is critical to future market

acceptance of its products. Although the Company attempts to encourage such development, it competes for software developers' resources with competitors having substantially greater market share and installed product base, and will have no control over the pace of continued applications software development for its products.

Competition for Sales Channels. The Company sells its microcomputer products primarily to independent computer specialty dealers (who usually also carry competing microcomputer products) and, in the case of the 520 ST and the XE series, to national retailers, for resale to end-users. Maintenance and growth of these relationships is essential to growth of the Company's sales. Competition for these dealers' and retailers' shelf space is intense. The Company's existing independent dealers and retailers are not committed to carry the Company's computers, and competitive factors could cause them to change to the products of another manufacturer at any time.

Dependence on Key Personnel. The Company's success depends on the management skills of its executive officers, who, collectively, are its principal shareholders, and on its management team, which includes key employees with extensive prior experience in the microcomputer industry. Loss of the services of a significant number of the executive officers or of these key employees would have a material adverse effect on the Company. The computer and entertainment electronics industries are characterized by a high level of employee mobility and aggressive recruiting of skilled personnel among competitors. The Company competes with many other companies that have much greater financial and other resources for attracting and retaining qualified engineering and management personnel with the experience, creativity and qualifications required by the Company. The ability to continue to locate, hire, train and retain such personnel is essential to the Company's continued product development efforts and growth. See "Management."

Dependence on Single Manufacturing Facility. The Company's manufacturing is centralized at its facility in Tam-Shui, Taiwan. Accordingly, the Company is subject to risks of economic and political disruptions, transportation time and delays, labor strikes, changes in laws and government policies, the imposition of duties, and import and export controls in Taiwan. See "Business — Manufacturing."

Voting Control. Upon conclusion of this offering, the Tramiel family will beneficially own approximately 53% of the Company's Common Stock. The Company's Articles of Incorporation do not provide for cumulative voting in the election of directors. Therefore, after this offering, the Tramiel family will be able to elect all of the Company's directors and to control the Company. See "Principal Shareholders."

Shares Eligible for Future Sale. Commencing 90 days after completion of this offering, approximately 489,143 shares of Common Stock owned by existing shareholders will be eligible for sale, from time to time, in the public securities market subject to the restrictions of Rule 144. Commencing 180 days after completion of this offering, an additional approximately 21,133,000 shares of Common Stock owned by principal shareholders and WCI will become eligible for sale subject to the restrictions of the Rule. In addition, WCI holds certain piggyback and demand registration rights with respect to its shares of Common Stock received in the WCI Transaction. See "Business — The WCI Transaction." Sale of such shares in whole or in part, or even the fact that they are available for sale, may have an adverse effect upon the market price of the Common Stock. See "Principal Shareholders — Shares Eligible for Future Sale."

USE OF PROCEEDS

The net proceeds to the Company from the sale of the shares of Common Stock, after deducting the expenses of the offering, are estimated to be $ ($ if the over-allotment option is exercised in full). Approximately $ of that amount will be used to repay indebtedness, including $36.1 million of acquisition indebtedness (including interest at 17%) to WCI. See "Business — The WCI Transaction." The balance of such proceeds will be used to increase the Company's working capital. Specific uses of working capital will depend upon business conditions. Pending such applications, the net proceeds will be invested in short-term interest-bearing obligations.

The Company will not receive any portion of the proceeds from sales of shares by the Contingent Selling Shareholders in the event the Underwriters' over-allotment option is exercised. See "Principal Shareholders" and "Underwriting."

DIVIDEND POLICY

The Company has not paid cash dividends and currently intends to retain future earnings to finance the development and expansion of its business.

DILUTION

At June 30, 1986, the Company had a pro forma net tangible book value of $17,175,000 (approximately $.73 per share of Common Stock) after giving effect to the issuance of 7.1 million shares of Common Stock as part of the WCI Transaction. See Notes 2, 5 and 9 to Financial Statements and "Business — The WCI Transaction." Without taking into account any other changes in net tangible book value subsequent to June 30, 1986, other than giving effect to the sale of 4.5 million shares offered by this Prospectus and the application of the net proceeds of such sale, the Company's pro forma net tangible book value at June 30, 1986 would have been $, or $ per share. This represents an immediate increase in net tangible book value of $ per share to existing shareholders and an immediate dilution of $ per share to purchasers of the shares of Common Stock in this offering. The following table illustrates this per share dilution:

Public offering price per share		$
Pro forma net tangible book value per share as of June 30, 1986 (1)	$.73	
Increase in net tangible book value per share attributable to investment by purchasers		
Pro forma net tangible book value per share giving effect to this offering		
Immediate dilution to purchasers		$

(1) Pro forma net tangible book value per share is determined by dividing the number of shares of Common Stock outstanding after giving effect to the issuance of 7.1 million shares of Common Stock to WCI in the WCI Transaction, into the pro forma net tangible book value of the Company (total assets less total liabilities).

The following table summarizes as of the consummation of this offering the differences between existing shareholders, including WCI, and the new purchasers with respect to the number of shares of Common Stock acquired from the Company, the total consideration paid and the average consideration per share.

	Shares Purchased		Total Consideration		Average Price Per Share
	Number	Percent	Amount	Percent	
Current shareholders(1)	23,762,350	84.1%	$87,827,000	%	$3.70
Purchasers in this offering	4,500,000	15.9			$
Total	28,262,350	100.0%	$	100%	

The data in the above tables assumes no exercise of outstanding stock options. See "Management — Stock Option Plan."

(1) The consideration paid by WCI has been valued at $54.0 million, which represents (i) the value of the net assets acquired less the value of the cash portion of the purchase price at the date of acquisition, plus (ii) the working capital loans (including accrued interest).

CAPITALIZATION

The following table sets forth the unaudited pro forma consolidated capitalization of the Company at June 30, 1986, giving effect to the issuance of 7.1 million shares of Common Stock to WCI as part of the WCI Transaction, and as adjusted to give effect to the sale by the Company of 4.5 million shares of Common Stock pursuant to this offering and the application of the estimated net proceeds from the sale, including the payment of approximately $36.1 million to WCI as part of the WCI Transaction. See Notes 2, 5 and 9 to Financial Statements and "Business — The WCI Transaction."

	Pro Forma	Pro Forma As Adjusted
	(dollars in thousands)	
Current maturities of long-term obligations	$ 4,716	$
Long-term obligations, excluding current maturities (1):		
Obligation due WCI	$34,182	$ —
Other obligations	1,343	
Total	35,525	
Shareholders' equity:		
Preferred stock, $.01 par value, 10,000,000 shares authorized, none outstanding	—	—
Common stock, $.01 par value, 100,000,000 shares authorized, 23,687,600 shares outstanding and 28,187,600 shares as adjusted for this offering (2)	237	282
Additional paid-in capital	86,276	
Notes receivable from sale of common stock	(1,921)	(1,921)
Accumulated deficit	(64,672)	(64,672)
Accumulated translation adjustments	(2,745)	(2,745)
Total shareholders' equity	17,175	
Total capitalization	$52,700	$

(1) See Note 5 to Financial Statements. Accrued interest on the obligation due WCI will increase the obligation to approximately $36.1 million at the consummation of this offering.

(2) Excludes 12,000 shares of Common Stock reserved as of June 30, 1986 for issuance pursuant to outstanding stock options and 39,000 shares with respect to which the Company intends to grant stock options. See "Management — Stock Option Plan" and Note 9 to Financial Statements.

SELECTED FINANCIAL DATA

The selected financial data for and at the end of the period from May 17, 1984 to December 31, 1984, the year ended December 31, 1985 and the six months ended June 30, 1986 have been derived from financial statements examined by Deloitte Haskins & Sells, independent public accountants. The information set forth below should be read in conjunction with the Company's financial statements and related notes and with Management's Discussion and Analysis of Results of Operations and Financial Condition. The results of operations for the six months ended June 30, 1986 are not necessarily indicative of the results to be expected for the full year. In the opinion of management, the unaudited information for the six months ended June 30, 1985 contains all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the results for such period.

Statement of Operations Data:

	May 17, 1984 (Inception) to December 31, 1984	Year Ended December 31, 1985	Six Months Ended June 30, 1985	Six Months Ended June 30, 1986
	(in thousands, except per share data)			
Net sales:				
New and redesigned products	$ 16,115	$ 47,817	$ 6,766	$ 89,069
Purchased products	94,565	94,170	40,886	16,517
Total	110,680	141,987	47,652	105,586
Costs and Expenses:				
Cost of sales:				
New and redesigned products	9,476	28,666	4,355	49,284
Purchased products	129,050	100,133	49,089	16,029
Liquidation and transition costs	13,131	4,966	4,966	—
Research and development	3,451	9,452	4,569	6,216
Marketing and distribution	10,630	17,536	7,544	11,957
General and administrative	6,397	7,053	3,465	5,221
Total	172,135	167,806	73,988	88,707
Operating income (loss)	(61,455)	(25,819)	(26,336)	16,879
Other income — net	1,883	19,904	3,750	2,385
Interest income	1,824	741	351	872
Interest expense	(5,010)	(9,140)	(4,440)	(4,934)
Income (loss) before income taxes and extraordinary credit	(62,758)	(14,314)	(26,675)	15,202
Provision for income taxes	—	—	—	6,735
Income (loss) before extraordinary credit	(62,758)	(14,314)	(26,675)	8,467
Extraordinary credit (1)	—	—	—	3,933
Net income (loss)	$(62,758)	$(14,314)	$(26,675)	$ 12,400
Per share data (2):				
Income (loss) before extraordinary credit	$ (2.78)	$ (.62)	$ (1.18)	$ .38
Net income (loss)	$ (2.78)	$ (.62)	$ (1.18)	$ .56
Number of shares used in the computation (2)	22,554	23,033	22,593	23,762

Balance Sheet Data (in thousands):

	December 31,		June 30, 1986	
	1984	1985	Historical	Pro forma (3)
Working capital	$ 13,820	$ 11,749	$ 39,732	$ 40,654
Total assets	185,263	139,044	134,288	134,288
Long-term obligations (including current portion)	41,257	57,082	64,978	40,241
Shareholders' equity (deficiency)	(6,899)	(19,477)	(8,484)	17,175

(1) Tax reduction from use of loss carryforwards. See Note 8 to Financial Statements.

(2) Per share computations for all periods include 7.1 million shares to be issued to WCI concurrently with completion of this offering. Per share computations for the six months ended June 30, 1986 include income before extraordinary credit of $.02 per share and net income of $.04 per share resulting from satisfaction of interest expense related to working capital loans from WCI by issuance of a portion of these shares. See "Business — The WCI Transaction" and Note 1 to Financial Statements.

(3) Reflects partial payment of the purchase price of net assets acquired from WCI and satisfaction of approximately $24.7 million of obligations to WCI and accrued interest by issuance of shares of Common Stock. See "Business — The WCI Transaction" and Notes 2, 5 and 9 to Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Introduction

The Company commenced operations in May 1984, and in July 1984 it acquired certain computer and video game system assets and assumed certain liabilities from WCI. See "Business — The WCI Transaction" and Notes 2, 5 and 9 to Financial Statements. The Company's net sales from its inception through June 1985 consisted primarily of the liquidation of the inventories of 600XL and 800XL 8-bit computers and associated disk drives and printers, and 2600 VCS and 5200 video game systems that were a part of the assets acquired from WCI. These inventories are referred to as the "purchased products" in the Company's financial statements and in the tables in this Prospectus.

Sales of the Company's re-engineered and redesigned 2600 VCS video game system commenced in the last quarter of 1984, and the Company introduced its 7800 ProSystem in May 1986. The Company began shipments of its 65XE and 130XE 8-bit computers in the second quarter of 1985 and of its 520ST 16/32-bit computer in the 1985 third quarter. The 1040ST was introduced in the first quarter of 1986. These products and certain peripheral products, such as disk drives and printers, are referred to as the "new and redesigned products" in the Company's financial statements and in the tables in this Prospectus.

Quarterly Results

The following table sets forth certain unaudited quarterly information for the last six fiscal quarters. The Company has not previously prepared interim financial information for public use. The amounts reflected below have been prepared based on a retrospective review by the Company. The quarterly results should be read in conjunction with the Financial Statements included in this Prospectus. This information includes all normal recurring adjustments that the Company considers necessary for a fair presentation.

	Three Months Ended					
	March 31, 1985	June 30, 1985	September 30, 1985	December 31, 1985	March 31, 1986	June 30, 1986
	(in thousands, except per share data) (Unaudited)					
Net sales:						
New and redesigned products	$ 819	$ 5,947	$15,267	$25,784	$33,558	$55,511
Purchased products	23,867	17,019	13,718	39,566	11,319	5,198
Total	24,686	22,966	28,985	65,350	44,877	60,709
Costs and Expenses:						
Cost of sales:						
New and redesigned products	518	3,837	9,206	15,105	18,860	30,424
Purchased products	29,069	20,020	13,210	37,834	10,952	5,077
Liquidation and transition costs	2,592	2,374	—	—	—	—
Research and development	2,295	2,274	2,353	2,530	2,928	3,288
Marketing and distribution	3,716	3,828	4,236	5,756	5,415	6,542
General and administrative	1,758	1,707	1,798	1,790	2,153	3,068
Total	39,948	34,040	30,803	63,015	40,308	48,399
Operating income (loss)	(15,262)	(11,074)	(1,818)	2,335	4,569	12,310
Other income	1,763	1,987	1,438	14,716	892	1,493
Interest income	267	84	39	351	372	500
Interest expense	(2,301)	(2,139)	(2,197)	(2,503)	(2,545)	(2,389)
Income (loss) before income taxes and extraordinary credit	(15,533)	(11,142)	(2,538)	14,899	3,288	11,914
Provision for income taxes(1)	—	—	—	—	1,457	5,278
Income (loss) before extraordinary credit	(15,533)	(11,142)	(2,538)	14,899	1,831	6,636
Extraordinary credit — tax reduction from use of net operating loss carryforwards(1)	—	—	—	—	851	3,082
Net income (loss)	$(15,533)	$(11,142)	$(2,538)	$14,899	$ 2,682	$ 9,718

(1) Provision for income taxes is based on the efffective tax rate for the six months ended June 30, 1986 of 44%. Extraordinary credit for the six months ended June 30, 1986 was allocated to the first two quarters of 1986 based on the provision for income taxes for each of those quarters.

The following table sets forth the percentage contribution to the Company's total net sales for the last six fiscal quarters from sales of the Company's new and redesigned computers and video game systems and from liquidation of the 8-bit computer and video game products purchased from WCI:

	Three Months Ended					
	March 31, 1985	June 30, 1985	September 30, 1985	December 31, 1985	March 31, 1986	June 30, 1986
New and redesigned products:						
Computers	—%	17%	41%	34%	63%	64%
Video games	3	9	12	5	12	27
Total	3	26	53	39	75	91
Purchased products	97	74	47	61	25	9
Total net sales	100%	100%	100%	100%	100%	100%

The Company believes that increased sales of 8-bit computer and video game systems in the fourth quarter of 1985 resulted from seasonality of these products, which the Company sells principally through national retailers. Because of this seasonality, the Company expects net sales during the fourth quarter to represent a disproportionate percentage of its annual net sales of these products.

Results of Operations for the Six-Month Periods Ended June 30, 1985 and 1986

The improvement from an operating loss of $26,336,000 in the six months ended June 30, 1985 to operating income of $16,879,000 in the six months ended June 30, 1986 was primarily attributable to the 122% increase in net sales in the 1986 period. That increase resulted from the increase in sales of the Company's new and redesigned products, which represented 14% of net sales in the 1985 period and 84% of net sales in the 1986 period. Sales of new and redesigned products during the six months ended June 30, 1986 included net sales of the Company's computer products of $67,079,000, or 63% of total net sales, and net sales of video game systems of $21,990,000, or 21% of total net sales.

The 60% decline in sales of purchased products from the 1985 period to the 1986 period resulted principally from two factors: during the first six months of 1986, the Company focused primary attention on developing independent computer specialty dealer distribution channels for its 520ST and newly introduced 1040ST computers; and during the same period several key national retailers, the primary source of the Company's sales of purchased products, continued to reduce or eliminate video game and 8-bit microcomputer system purchases because of excess inventories. At June 30, 1986 remaining inventories of purchased products were approximately $22,591,000. The Company believes that revenues from liquidation of the remaining inventories of these purchased products will not be material after 1986.

The increase in the Company's gross profit margin on sales of its new and redesigned products from 36% for the six months ended June 30, 1985 (40% for all of 1985) to 45% during the six months ended June 30, 1986 reflects higher costs associated with initial production in the 1985 period and cost of sales increasing more slowly than net sales, resulting from manufacturing efficiencies and economies of scale attendant to materially increased production in the 1986 period.

Liquidation and transition costs of $4,966,000 incurred in the six months ended June 30, 1985 include certain employment and occupancy costs incurred by the Company during liquidation of excess plant and operating assets acquired in the WCI Transaction.

All of the Company's research and development expense in the 1985 and 1986 periods related to development of its new and redesigned products. Although research and development expenses increased in absolute value in the first six months of 1986 as compared to the prior period, it decreased as a percentage of net sales because of the substantial increase in net sales in that period. The Company currently anticipates that research and development expenditures will approximate five to six percent of net sales.

Marketing and distribution and general and administrative expenses increased in absolute terms but decreased as a percentage of net sales because of the substantial increase in net sales in the 1986 period.

Results of Operations from Inception to December 31, 1985

The 15% contribution of the Company's new and redesigned products to net sales in the 1984 period resulted entirely from sales of the re-engineered and redesigned 2600 VCS video game system, principally in the 1984 Christmas season. The increase in contribution of the Company's new and redesigned products

from 15% of net sales in 1984 to 34% in 1985 resulted from continued sales of the re-engineered and redesigned 2600 VCS video game system and commencement of sales of the Company's 65XE and 130XE 8-bit computers and its 520ST 16/32-bit computer. Sales of the Company's 65XE, 130XE and 520ST computers represented $38,069,000, or 27% of total net sales for 1985.

Negative gross margins attributable to the sale of purchased products for 1984 and through June 1985 reflect writedowns of inventories of those products to estimated net realizable value. The reduction in cost of sales as a percentage of net sales between 1984 and 1985 was the result of two factors: the positive gross margins attributable to increased sales of the Company's new and redesigned products in 1985, and net sales realized on liquidation of purchased 2600 VCS video game systems during the second half of 1985 that were in excess of resale prices anticipated in reducing purchased inventories to estimated net realizable value at the end of 1984.

Research and development expenses represented 3% and 7% of net sales in 1984 and 1985, respectively. All of the research and development expense was attributable to development of the Company's new and redesigned products.

Because the Company's expenses in the seven and one-half months of its operations in 1984 were heavily affected by start-up and liquidation and transition costs, the Company does not believe that comparisons of other components of costs and expenses in fiscal 1984 with fiscal 1985 is meaningful.

Other income of $1,883,000 in fiscal 1984 resulted primarily from sales of excess property and equipment purchased from WCI. Other income of $19,904,000 in fiscal 1985 included approximately $6,900,000 from continued sales of excess property and equipment acquired from WCI and approximately $11,000,000 from resale to WCI of certain warrants to purchase Warner Communications, Inc. stock acquired by the Company as part of the WCI Transaction. See Note 2 to Financial Statements.

International Sales

International net sales (including export sales) for fiscal 1984 and 1985 and the six months ended June 30, 1986 were $47,668,000, $85,388,000 and $62,308,000 (43%, 60%, and 59% of net sales), respectively. For additional information on net sales, operating income and identifiable assets associated with international operations by geographic region see Note 10 to Financial Statements. The Company's international operations are subject to the risks of fluctuation of the values of the U.S. dollar and foreign currencies. For information concerning the effect of foreign currency transactions on the Company's results of operations through June 30, 1986 see Note 1 to Financial Statements.

Liquidity and Capital Resources

The Company's initial working capital consisted of approximately $30.9 million received from sales of Common Stock and the Company's purchase of operating assets in the WCI Transaction, which has not required payment of cash to WCI prior to the completion of this offering. Additional working capital has been provided from operations, $24.7 million of working capital advances from WCI, sales to third parties of excess property and equipment received in the WCI Transaction and resale to WCI, for $15 million, of warrants received in the WCI Transaction. See Note 2 to Financial Statements and "Business — The WCI Transaction." Pursuant to an agreement with WCI, the proceeds from the sale of the warrants are restricted to use by the Company to settle or satisfy judgments resulting from certain third party claims asserted against WCI and the Company relating to activities of WCI prior to the WCI Transaction. See "Business — Legal Proceedings." WCI does not intend to make additional working capital advances to the Company.

The Company believes that the proceeds of this offering, together with existing cash balances and funds anticipated to be generated from operations, will be sufficient to meet its cash requirements through June 1987, and that it will not be necessary to raise additional funds to meet expenditures required to operate the Company's business during that period. However, the Company has no bank or institutional credit lines and intends to seek such credit lines for use in connection with future working capital and capital asset development needs. No negotiations have commenced with prospective lenders, and no assurance can be given that any such credit lines can be established on terms acceptable to the Company. No specific uses of any such future borrowings have been identified at the date of this Prospectus.

BUSINESS

The WCI Transaction

In May 1984, Jack Tramiel founded the Company and began assembling a management team to undertake development, manufacture and marketing of microcomputer systems designed to offer advanced technology at low prices. In July 1984, the Company acquired from WCI certain assets, including inventories of the Atari 600XL and 800XL 8-bit microcomputers and associated disk drives and printers, and of 2600 VCS and 5200 video game players and game software, and the exclusive right to the Atari name and logo for the Company's computer and consumer products. These assets were subject to certain then existing and contingent obligations and liabilities. In November 1985, the Company resold to WCI warrants acquired in the 1984 asset acquisition for $15 million, of which $13.9 million was deposited in escrow to fund settlements or judgments, if any, obtained in certain litigation related to these obligations and liabilities. See "Business — Legal Proceedings" and Notes 2 and 12 to Financial Statements.

Between July 1984 and June 30, 1986, WCI advanced to the Company working capital of $24.7 million (bearing interest at 10.5%) that was used to satisfy certain liabilities assumed in the 1984 asset acquisition.

The consideration given by the Company in the 1984 asset acquisition was subject to adjustment based upon the Company's and WCI's subsequent evaluation of the assets acquired and the associated obligations and liabilities. In August 1986, the Company and WCI completed that evaluation and agreed that, for the net assets the Company acquired in the 1984 transaction, and accrued interest on the purchase obligation at 17%, and in repayment of WCI's working capital loans to the Company, including accrued interest, upon consummation of this offering, the Company would issue to WCI 7.1 million shares of Common Stock, and pay to WCI approximately $36.1 million. The Company's approximately $36.1 million obligation to WCI will be paid from the proceeds of this offering.

As a result of the WCI Transaction, upon consummation of this offering, WCI will own 7.1 million shares of the Company's Common Stock, constituting approximately 25% of the Common Stock to be outstanding. WCI does not intend to make additional advances to the Company.

Products

Introduction.

The Company's revenues and results of operations from its inception through June 1985 resulted primarily from liquidation of 8-bit microcomputer and video game system inventories that were a part of the assets acquired in the WCI Transaction. The Company used the net cash flow from that liquidation for payment of associated obligations and liabilities and continued research and development of its own computer and video game system product lines.

In early 1985, the Company introduced its first computer products, its 65XE and 130XE 8-bit computers, targeted for the entry-level computer user and compatible with peripheral products and several hundred software programs already then available for the microcomputer inventories being liquidated from the WCI Transaction. In June 1985, the Company introduced the 520ST, the first of its ST series of 16/32-bit microcomputers, and in January 1986 it introduced the 1040ST. As of September 15, 1986, the Company had sold over 150,000 ST systems worldwide. The Company currently intends that its principal product development efforts will focus on enhancements of and peripheral products for the ST series.

The Company's video game system products consist of the 2600 VCS, introduced in late 1984, and the 7800 ProSystem, introduced in May 1986. The Company intends to expand its offering of microprocessor-based consumer entertainment products.

See Note 10 to Financial Statements for information regarding the Company's industry segment.

The ST 16/32-bit Microcomputer Series.

The centerpiece of the Company's product lines is its ST series of microcomputer systems. The Company's business strategy is to offer advanced microcomputer technology and to structure and price the ST series as an industry leader based on the relationships of price-to-memory capacity and price-to-processing speed.

The following table compares the features of the Company's ST microcomputers against standard system configurations of microcomputers currently offered by certain major manufacturers whom the Company believes to be its principal competitors. Prices are manufacturers' list prices, which are subject to change and are frequently subject to reduced price promotions, and selected dealer discounts are widely available for some machines, particularly for the IBM PC product line. Accordingly, actual retail prices are often lower.

	ATARI 1040ST(1)	IBM PC-AT(2)	APPLE MACINTOSH PLUS(3)	COMMODORE AMIGA	LEADING EDGE MODEL D	TANDY 1000EX	COMPAQ DESKPRO 286	KAYPRO 286i
Manufacturer's list price	$ 999(mono) 1,199(color)	$4,675	$2,195	$1,795	$1,295	$1,198(mono) 1,498(color)	$3,998	$2,995(mono) 3,195(color)
Microprocessor	68000	80286	68000	68000	8088	8088	80286	80286
Speed (MHz)	8.0	8.0	7.83	7.16	4.77	4.77	8.0	6.0
Standard user-accessible RAM	1024K	256K	1024K	256K	512K	384K	256K	512K
Cost per RAM kilobyte	$0.98	$18.26	$2.44	$7.01	$2.34	$3.90	$17.57	$6.24
Operating system in ROM	Yes	No	Yes	No	No	No	No	No
Number of keys	94	84	78	89	84	90	84	84
Mouse	Yes	No	Yes	Yes	No	No	No	No
Floppy disk drive	3½"	5¼"	3½"	3½"	5¼"	5¼"	5¼"	5¼"
Number of floppy disk drives	1	1	1	1	2	2	1	2
Hard disk port	Yes	Yes	Yes	No	Optional	Optional	Optional	Optional
Color video capability	Yes	Optional	No	Yes	Yes	Yes	Yes	Yes
Number of colors	512	16	None	4096	16	16	16	16
Screen resolution								
Color	640x200	640x200	None	640x400	320x200	640x200	640x200	320x200
Hi-Res monochrome	640x400	Optional	512x342	None	720x348	640x200	Unknown	640x200
Built-in MIDI interface(4)	Yes	No	No	No	No	No	No	No
Sound voices	3	1	4	4	1	3	1	1

(1) The Company's 520ST offers the same features as the 1040ST, except that it includes 512K of RAM and a stand-alone 3½" disk drive, at a suggested retail price of $799 (monochrome monitor) and $999 (color monitor).

(2) The IBM PC is based on the Intel 8088 microprocessor, operates at a slower speed (4.77 MHz) than the PC-AT, uses an 84-key keyboard, offers a 320 by 200 unit color screen resolution, and bears a suggested retail price of $2,495. The recently announced IBM PC-XT 286 is based on the Intel 80286 microprocessor, includes 640K RAM, a 5¼" floppy disk drive and a hard disk drive, and operates at 8.0 MHz, at a suggested retail price of $3,995.

(3) The Apple Macintosh offers the same features as the Macintosh Plus, except that it includes 512K of RAM and a 59-key keyboard, at a suggested retail price of $1,995. Apple recently announced the 8/16-bit Apple IIgs, offering 256K RAM (expandible to one megabyte at extra cost), music and voice simulation, graphics, a mouse and high resolution monitor (sold separately), at apparent retail prices between $1,600 and $1,900.

(4) A MIDI is an interface that permits communication between the computer and a music synthesizer.

Hardware and Operating System Features. The Company's ST computer line currently consists of two models, the 520ST and the 1040ST. At the heart of both machines is the Motorola 68000 microprocessor which simultaneously processes 32-bits of information internally and communicates over a 16-bit channel. By comparison, the IBM PC operates on 16-bits of information internally and communicates over an 8-bit channel, making it considerably slower in processing information than 32-bit machines. The ST operates its microprocessor at a speed of eight million cycles per second (eight megahertz), making it one of the fastest standard 16/32-bit configuration microcomputers of which the Company is aware.

The 520ST and 1040ST contain 524,288 (512 kilobytes) and 1,048,576 bytes (one megabyte) of internal random access memory ("RAM"), respectively, permitting storage in the computer of applications software and data for various computer functions, such as word processing, database management, spreadsheets and graphics. For example, in a word processing function, the one megabyte RAM capacity of the 1040ST can hold over 250 pages of standard text. Within the next twelve months, the Company intends to introduce two and four megabyte versions of the ST line.

Microprocessor speed and internal memory capacity can be restricted by the inability to move information to and from memory or external devices. The ST line contains four customized circuits that coordinate and expedite the movement of information. For example, in the ST, information can be moved from memory to the video monitor without impeding the transfer of information from the microprocessor to memory. Similarly, direct channels between the internal memory and external devices allow the ST to transfer information to disk drives without burdening the microprocessor.

A computer's operating system is the internal software that manages the computer's hardware and provides fundamental resources for working with applications programs introduced into the RAM. On many computers (for example, the IBM PC) the computer's operating system must be loaded from a disk into RAM which would otherwise be available for applications software, such as word processing or spreadsheet programs. However, the ST operating system is stored in the computer in 196,608 bytes of permanent read only memory ("ROM"), eliminating loading time and leaving the ST's RAM free for applications software and data storage.

A substantial part of the ST operating system is the Graphics Environment Manager ("GEM"). GEM is based on two fundamental principles. First, it is designed to enable the user to operate the computer by pointing to images shown on the video monitor representing a familiar office environment and executing functions through the two-button "mouse", as well as through the 94-key keyboard. This capability obviates the need to type frequent cryptic commands, making computer use faster and more intuitive. For example, a picture of a file cabinet represents the computer's file system. By pointing to the file cabinet image, the user can examine its contents and then dispose of, display or print its contents by pointing to the image representing the desired operation.

The second fundamental principle underlying GEM is its adaptability to different existing hardware products, as well as to future hardware products that exceed current microcomputer technology. For example, a word processing program that will operate on the Company's 640 x 400 unit high resolution monochrome monitor will also operate on the Company's lower resolution color monitor. If the Company were to introduce a monitor with 1280 x 960 unit resolution, the same word processing program would operate on the improved system. Accordingly, a new computer of the ST line will be able to use the existing ST series software base without limiting the Company's ability to offer consumers enhanced capabilities.

The Company offers standard programming languages for the ST, including BASIC, the most widely used language among microcomputer users, and LOGO, a popular language, particularly among educators. Additional programming languages for the ST currently available from independent software vendors include the C language, Fortran, 68000 assembly language, Forth, Pascal, Modula-2 and LISP.

Applications Software. To promote sales of its products in international markets, the Company relies upon a policy of actively encouraging ST applications software development, not only by major independent software developers in the United States, but by formerly under-utilized European software developers. The Company's strategy is to promote software for local markets to reflect local needs. To facilitate development

of software by others, the Company provides detailed information concerning its ST architecture and operating system, offers consulting services of its technical staff without charge and assists marketing efforts of software developers.

As of September 15, 1986, approximately 300 applications software products were available from United States software developers, and a similar number were available from software developers outside the United States. Available ST software products currently include word processing programs; spreadsheets, including the VIP Professional (a Lotus 1-2-3 compatible); databases, including Versasoft's DB MAN (an Ashton-Tate dBASE III work-alike); graphics and electronic publishing software; entertainment software; musical composition programs; computer-aided design software; and an "expert system" using artificial intelligence techniques.

The Company's microcomputers were only recently introduced and do not use the MS-DOS operating system that is the basis of IBM and IBM-compatible microcomputers, which account for the majority of microcomputer sales. Accordingly, these and other competitors, whose computers have a materially larger installed base than the Company's, have considerably larger existing software libraries than the Company. The Company's ability successfully to promote and encourage further software development for the ST line will be critical to the future growth of its sales. Over 3,000 orders have been received for the Company's ST software development package; the Company believes that independent software developers currently developing software for the ST includes Microsoft, a major software house.

Peripheral Equipment. The ST line adopts industry standards for interconnecting peripheral hardware devices where the standards do not unduly limit performance. The ST includes a "Centronics" printer interface allowing connection to printers manufactured for the IBM PC, and an "RS-232" communications interface allowing connection to modems from industry leaders such as Hayes and Racal-Vadic.

The Company's line of peripheral equipment for the ST series is currently composed of color and monochrome monitors, 360K and 720K 3½-inch microfloppy disk drives, a 20 megabyte hard disk drive, and a dot matrix graphics and text printer. The Company is currently developing additional peripheral equipment and ST features, including a telecommunications modem, a laser printer, enhanced sound circuits, and a dedicated graphics co-processor that will generate graphics at up to five times current speeds.

The XE 8-bit Microcomputer Series.

The Company's XE series computers are targeted for the entry-level computer user and compete with such products as the Commodore 64 and Apple IIe 8-bit computers. They include the 130XE and the 65XE, which generally retail for less than $150 and $100, respectively. Both computers are compatible with peripheral equipment and several hundred software titles available for the 400/800, 1200XL and 600/800XL computer inventories liquidated from the WCI Transaction.

The XE series computers include a 1.79MHz 6502C microprocessor, 128K of RAM, 24K of ROM, built-in BASIC language, cartridge port, two joystick/paddle ports, and a 65-key full-stroke keyboard. Peripheral equipment includes a 5¼-inch disk drive, a letter quality printer, a dot matrix printer, an 80-column card for full-page word processing and spreadsheet applications, and a 300 baud modem.

Video Game Systems.

The Company believes it is the largest seller of video game systems in the United States. Sales of the Company's video game systems (not including liquidation of inventories of prior video game products acquired in the WCI Transaction) were $9,748,000 and $21,990,000 in 1985 and the first six months of 1986, respectively.

The Company acquired an inventory of the original Atari 2600 VCS video game systems from WCI in July 1984. The Company is liquidating the 2600 VCS inventory acquired from WCI and has materially re-engineered and redesigned the 2600 VCS as its own video game system. The new 2600 VCS, introduced in late 1984, is based on a standard 6507 microprocessor, a 6532 combination RAM, input/output and timer chip, and a custom video display chip. The Company has reduced the 2600 VCS's parts by a third, allowing the use of a single-sided printed circuit board, resulting in reduced labor and materials costs and increased

product reliability. In addition, new custom memory developments allow more sophisticated and elaborate graphics for game programs.

The 2600 VCS currently retails for less than $50, and plays video games designed for both the original and the new 2600 VCS.

In May 1986, the Company introduced its 7800 ProSystem video game system, featuring compatibility with all 2600 VCS game software and offering arcade quality graphics for new games designed for the 7800 ProSystem. The expanded memory capacity of the 7800 ProSystem allows it to run entertainment software heretofore available only on home computer systems. At June 30, 1986, eight classic arcade games, including Ms. Pac-Man, Joust and Pole Position II, were available for the 7800 ProSystem with enhanced graphics. The 7800 ProSystem generally retails for less than $100.

The Company intends to expand its offering of microprocessor-based consumer entertainment products.

Distribution, Sales and Marketing

United States. Since introduction of the 520ST in June 1985, the Company has followed the policy of selling its ST microcomputer products primarily to independent computer specialty dealers (who usually also carry competing microcomputer product lines), for resale to end-user customers. In general, these dealers also provide pre-sale and post-sale support, offer peripheral equipment such as disk drives and printers manufactured by the Company, and provide warranty and post-warranty repair services. Accordingly, since the Company's dealers serve as the principal point of contact between the Company's ST computers and end-users, their support services are important to the growth of the Company's ST computer sales.

Currently, over 800 dealers, served through regional distributors and directly by the Company, market the ST computer line in the United States. Although the Company sells its ST computers directly to individual stores of certain national computer specialty stores, its computers are not currently carried on a company-wide basis by the principal national chains, Micro-Age, ComputerLand, BusinessLand or Entre. New computer specialty dealer accounts are opened principally through a network of regional independent manufacturer's sales representatives. To expand further its distribution base, the Company has recently begun distributing its 520ST through mass market channels.

Because of their low retail prices and appeal to the entry-level computer user, the Company distributes its XE computers and video game systems primarily through national retailers, department stores and mail order outlets. Several key national retailers substantially reduced or eliminated microcomputer purchases in 1984 and 1985 and during the first six months of 1986 because of excess inventories and reduced profit margins. Although the Company believes that these problems are diminishing, and that many such mass market retailers are resuming their microcomputer product purchases, they can be expected quickly to curtail orders if increased consumer demand does not materialize.

Since the Company's policy is not to make direct sales of its products to end-users, the Company's ability to maintain and add retail specialty dealer and mass market retailer relationships will be an important determinant of its future revenues. Competition for dealer and retailer acceptance of microcomputer products is intense. Since the Company's independent dealers and retailers are not committed to carry the Company's products, they could reduce orders for the Company's products and change to the products of a competing microcomputer manufacturer at any time.

The Company tailors its advertising to the primary market targeted for each specific product. For example, the 2600 VCS and 7800 ProSystem video game systems, which appeal primarily to children and young adults, are mass marketed and promoted through television advertisements, generally telecast during Saturday morning programming. The XE and ST computers are generally promoted through print media, with direct advertisements principally in computer users' magazines. Except for its television advertisements, the Company depends substantially on its dealers for promoting the Company's products. The Company has participated in joint advertising programs with certain dealers from time to time.

The Company also encourages formation of regional users groups for support of the Company's products, and disseminates information concerning its products through its magazine, *Atari Explorer*. Recently, the Company retained the former publisher and editor of *Creative Computing* to produce the magazine and other publications promoting the Company's products.

International. The Company distributes its product lines, directly and through independent distributors, in approximately 50 countries outside the United States. Primary international distribution is by direct sales in West Germany, the United Kingdom, France, Italy, Switzerland, the Benelux countries and Canada. In other international markets, the Company distributes its products through approximately 25 independent national and regional distributors.

International distribution is tailored for each local market. Distributors translate software for the local language, and computer keyboards, electrical requirements and video outputs are adapted to conform to local and regional standards.

Sales of the Company's products outside North America for fiscal year 1985 and the six-month period ended June 30, 1986 constituted approximately 36% and 40% of all sales, respectively. For the same periods, export sales represented 24% and 19% of net sales, respectively. The Company's international sales are subject to certain risks common to non-United States operations in general, such as governmental regulation, import restrictions, and currency fluctuations. Accordingly, fluctuations in the dollar in relation to certain international currencies may affect the Company's sales to international customers.

See Note 10 to Financial Statements for information regarding revenues, operating profit (loss) and identifiable assets attributable to geographic regions.

Warranty and Customer Service

Video game and XE computer products are sold primarily through mass market retailers without on-site warranty or other service capability. Where the distributor does not have on-site warranty service capability, within the Company's 90-day warranty period, consumers may return defective products to the place of purchase for free repair or replacement. The Company in turn accepts in-warranty returns from distributors for credit, repair or replacement. Where a distributor or retailer has the capability to make on-site warranty repairs, the Company affords the distributor or retailer a warranty allowance against the product invoice price in exchange for assumption of the warranty service obligation.

After the 90-day warranty period expires, product repairs are made by independent service organizations authorized by the Company. The Company's distributors and retailers can purchase spare parts and have access to technical documentation and advice from the Company's service department.

The Company's limited warranty covers parts and labor for 90 days. The Company's allowance to distributors who assume the warranty obligation is deducted in computing its net sales; its provision for warranty expenses incurred by the Company is included in its cost of sales.

The Company is equipped to handle direct inquiries from consumers. Letters and telephone calls are screened and logged to monitor specific types of consumer problems and to provide timely response.

Product Development

Since the Company's inception, it has developed a broad range of computer and video game products. The ST computer series was developed by the Company, including the customized chip set that controls all aspects of ST computer functions. The Company has developed and announced plans to introduce enhancements and additional products for the ST line within the next twelve months. An additional graphics processor, which may be added to the 520ST or the 1040ST, will handle all graphics generating functions, freeing capacity of the existing central microprocessor for other functions and increasing the speed at which the computers respond to commands to generate graphics and pictorial representations to up to five times the speed of the current ST computers.

The Company also intends to develop and introduce additional microcomputer products, using the current ST operating system and compatible with current ST applications software, that will offer two and four megabytes of RAM and substantially enhanced color resolution and spectrum capacity.

The Company believes that its continued growth will depend on its ability to reduce costs of its current products and to create and market new and innovative personal computer and entertainment electronics products at prices below those charged by its competitors for comparable products. The introduction of any such new products typically requires at least a year of advance planning and design and substantial expenditures before market acceptance can be determined.

Market acceptance of the Company's products is also dependent upon the availability and market acceptance of applications software for the Company's products. The Company does not currently develop applications software, and plans for the foreseeable future to devote research and development resources to development of new hardware products. Accordingly, applications software for the Company's products is developed and produced by independent software publishers over which the Company has no control. The necessity for such continued new product introductions in the context of uncertain market acceptance and increasing price competition is a material risk of the Company's business plans.

The Company has spent and intends to continue to spend significant amounts for research and development of new microcomputer products and to reduce the cost of its products. The Company's research and development costs, which were primarily associated with development of its ST microcomputer series, were $3,451,000 in the seven months of its operations in 1984, $9,452,000 in 1985, and $6,216,000 for the first six months of 1986. As of September 15, 1986, approximately 80 Company employees were engaged in computer product development.

Manufacturing

The Company manufactures its products at its 200,000 square foot facility in Tam-Shui, Taiwan. The Company believes that the facility is sufficient to meet product manufacturing demands in the foreseeable future. However, since manufacturing is centralized in this single facility, the Company's operations are subject to risks of economic and political disruptions, transportation delays and imposition of government controls in Taiwan.

The manufacturing process uses modern and reliable equipment, including wave solderers and robotic circuit placing equipment, which reduce production costs and enhance product integrity. Quality safeguards and audits are incorporated into several phases of the production cycle. All printed circuit boards are placed in "burn-in" chambers to detect component failures. Randomly selected fully assembled systems pass through several audit tests and inspection stations.

The production process has been designed and is overseen by the Company's production engineering group, consisting of approximately 20 employees based in Japan.

Substantially all component parts and peripheral equipment not manufactured by the Company are acquired from multiple sources and have been readily available. Some components and peripheral equipment are available only from a limited number of suppliers. Although the Company believes that alternate sources of supply for such items could be developed if necessary, the disruption or termination of existing sources could have an adverse effect on the Company's operation.

The Company manufactures its products according to its forecast of near-term demand, and not primarily to specific customer orders. Warehoused inventories of finished products, estimated to fill sales and warranty return requirements, are maintained in advance of receipt of orders. An additional three-to-four week supply of finished product is generally in transit to the United States, and a five-to-six week supply is generally en route to Europe, by ship from the Company's Taiwan manufacturing facility. Orders are usually placed by purchasers on an as-needed basis and are usually filled from inventory shortly after receipt. The Company's backlog of orders at any time is generally not indicative of future sales.

Intangible Property Rights

The Company's most significant trademarks are its "Atari" name and logo, both of which were acquired from WCI for the Company's exclusive use in computer and consumer products. WCI retained the rights, including sublicense rights, to the "Atari" name and logo for use in coin-operated arcade video games. The Company also acquired from WCI a portfolio of patents, trademarks and copyrights, including all intangible property rights formerly owned by WCI in conjunction with its computer and video game businesses. The Company considers the ownership of patents in its segments of the microcomputer and entertainment electronics industries to be less significant than technological innovation, efficient production and product marketing strength.

The Company's rights to make, use and sell certain computer and video game software are held through licenses from third parties. The most significant license grants the Company an exclusive right to the operating system and a non-exclusive right to certain development tools developed by Digital Research Inc. for the ST series of computers. The operating system license is fully-paid and includes the right to produce unlimited copies.

The Company owns rights to a portfolio of approximately 40 patents in the field of optical display holography. The Company has an exclusive license with sublicense rights under the patents, but only for use in specified fields such as publishing, packaging, and games and novelty items. The Company receives royalties under a non-exclusive sublicense to American Bank Note, the principal producer of holograms in the United States. The Company has no current plans to exploit these holography patents other than by sublicensing its rights to third parties.

Facilities

The Company leases its 46,000 square foot corporate headquarters building at 1196 Borregas Avenue, Sunnyvale, California, and approximately 158,000 square feet of warehousing space located in two facilities.

The Company owns a manufacturing facility containing approximately 200,000 square feet situated on approximately 7½ acres in Tam-Shui, Taiwan, and leases 6,383 square feet of production engineering and office space in Tokyo, Japan for production engineering.

The Company leases international sales facilities, including 4,022 square feet of office space and 16,146 square feet of warehouse facilities near Toronto, Canada, and European sales offices in Slough, England; Paris, France; Frankfurt, West Germany; Baden, Switzerland; Amsterdam, Netherlands; and Milan, Italy.

Employees

At September 15, 1986, the Company had approximately 1,180 employees, including approximately 80 in engineering and product development, approximately 140 in marketing, sales and distribution, approximately 830 in manufacturing and production, and approximately 130 in general administration and management. The approximately 800 employees at the Company's Tam-Shui, Taiwan manufacturing facility are represented by a labor union. None of the Company's other employees is represented by a labor union. The Company considers its employee relations to be good.

Many of the Company's employees are highly skilled. The Company's business depends, to a great extent, on its ability to attract and retain highly skilled employees. The Company competes with many other high technology companies, many of whom have greater resources than the Company, for its employees. The high technology industry is characterized by a significant level of employee mobility among competitors.

Competition

The personal computer industry is highly competitive and has been characterized by rapid technological advances in both hardware and software and constant introduction of new products offering more features at lower cost. As the result of these competitive factors, during the last few years many computer manufacturers have announced significant operating losses, and several have discontinued personal computer product lines or sought bankruptcy protection.

The principal elements of competition among personal computer manufacturers are product quality and reliability, availability of software, ease of use, price/performance characteristics, service and support, availability of peripherals, marketing and sales capability, corporate reputation and capacity to deliver products in high volume.

Although the Company's ST computers have received favorable initial recognition, the Company's short operating history and only recent introduction of these products do not confirm its ability to satisfy these competitive factors on a continuing basis. The Company intends to continue to develop its computers to compete favorably with respect to such factors, with emphasis upon providing high performance at reduced price. However, there can be no assurance that comparable or superior products incorporating more advanced technology or other features at lower prices will not be introduced by competitors.

Over 100 manufacturers of personal computers, United States and international, compete for sales channels, customer attention and software development resources. The Company's principal microcomputer competitors are IBM, Apple, Commodore, Tandy, Amstrad, Olivetti SPA and several United States and international distributors of IBM compatible personal computers, including Compaq and Leading Edge Hardware Products, Inc. These competitors have longer operating histories, broader product lines, greater financial resources and larger personal computer market shares than the Company.

Since the Company relies heavily on an independent specialty dealer network for sales and service of its ST computers, it competes with these larger companies for dealer acceptance. Because full-service dealers sell and support only a limited number of microcomputer products, and the total number of dealers in the United States has apparently remained relatively stable over the past two years, competition for these dealers' limited shelf space is and is likely to remain intense. These dealers, including particularly national computer specialty store chains, make decisions on carrying microcomputer product lines based primarily on their relative ease of resale to customers, rate of inventory turnover and size of associated profit margins. Since the Company's independent dealers are not committed to carry the Company's products, these competitive factors could cause them to change to the products of a competing microcomputer manufacturer at any time. Although the Company has sold its ST computers to selected stores of major computer specialty store chains, the Company's computers are not currently carried on a company-wide basis by Micro-Age, ComputerLand, BusinessLand or Entre, the principal national computer specialty store chains.

IBM and manufacturers of IBM compatible personal computers, which use the MS-DOS operating system, control a dominant portion of the market for personal computers for business use. The Company's personal computers do not use the MS-DOS operating system and are not currently compatible with IBM and IBM compatible computers. This lack of compatibility may limit acceptance of the Company's computers in the business market and impede the development of applications software for its computers.

Although the Company's ST computers are offered at prices below suggested retail prices of IBM, Apple and certain other competing products, many such computer products are regularly available at substantial discounts from suggested retail prices. Some IBM compatible computers are also being offered by United States and international manufacturers at prices equal to or less than the prices of the Company's ST computers. During the last 12 months, IBM has announced reductions in the prices of its personal computers that are widely regarded as further intensifying competitive price reductions in the personal computer market. In addition, Tandy has recently introduced new microcomputer products at reduced prices, and IBM, Apple and Compaq have announced new computer products with enhanced features. These factors could force price reductions for the Company's products, reduce its profit margins and increase difficulty in obtaining or maintaining its market share.

Legal Proceedings

As a consequence of the WCI Transaction, the Company has been named as a defendant in litigation that has arisen as a result of the activities of WCI, and not the Company. In November 1985, the Company and WCI agreed to establish a $13.9 million escrow account from proceeds received by the Company from sale of certain warrants received in the WCI Transaction, to satisfy any judgments that might be rendered in certain of these actions or to resolve them by settlement. The escrowed funds are not available to cover

the Company's expenses of defending these actions. The Company will be responsible for the amount of any judgments or settlements in excess of the escrow amount and will receive any funds remaining in the escrow account after resolution of these actions. Of the 92 cases covered by the escrow, 76 have been resolved. Although the Company believes that the remaining actions can be resolved for less than the amount remaining in the escrow account, there can be no assurance that the remaining funds will be sufficient for that purpose.

On or about September 19, 1984, Stargate Enterprises filed an action against the Company, WCI, and Williams Electronics in the United States District Court for the Northern District of California alleging, among other things, trademark infringement, unfair competition, dilution of trademark, and false designation of origin of products. The complaint seeks $25 million in punitive and general damages. Williams Electronics has agreed to indemnify the Company and WCI, and to bear any damages arising out of these claims, as well as attorneys fees and costs. WCI has also agreed to indemnify the Company for any damages arising out of any trademark infringement alleged to have occurred prior to July 1, 1984. The Company believes that this action will have no material adverse effect on its financial condition.

On or about June 28, 1985, an alleged class action was filed in California Superior Court for Santa Clara County by Maria Carson and Rudolfo Villanueva against the Company alleging damages in excess of $13 million. This action was filed as a companion to another class action filed by the same named plaintiffs against WCI. This latter action has now been settled and approved by the court, subject to notice to the class and the right of class members to challenge the settlement. As part of the settlement, the plaintiffs have agreed to dismiss with prejudice all claims against the Company arising out of the events alleged in the complaint. The Company is not required to contribute to any proposed settlement.

On August 9, 1985, Alps Electric (USA) Inc. filed an action against the Company and WCI in the California Superior Court for Santa Clara County, alleging amounts due for goods sold and delivered and cancellation charges. The complaint seeks $6.8 million from the Company in general damages, plus interest. This case is not covered by the escrow account referred to above. Discovery is in process, and the matter is scheduled for trial in October 1986.

MANAGEMENT

Directors and Executive Officers

The directors and executive officers of the Company are as follows:

Name	Age (At June 30, 1986)	Position(s) Held
Jack Tramiel	58	Chairman of Board, Chief Executive Officer and Director
Sam Tramiel	36	President, Chief Operating Officer and Director
Samuel W.L. Chin	36	Vice President, General Manager-Atari Taiwan Manufacturing Corporation and Director
Leonard I. Schreiber	72	Director
Gregory A. Pratt	37	Vice President-Finance, Chief Financial Officer and Treasurer
Taro Tokai	40	Vice President
Garry Tramiel	26	Secretary, Assistant Treasurer and Vice President-Administration
Shiraz Shivji	38	Vice President-Advanced Technologies
Leonard Tramiel	31	Vice President-Software Development
Michael V. Katz	43	Vice President-Marketing and Entertainment Electronics
Thomas Brightman	31	Vice President-Production Engineering
Joseph Spiteri	56	Vice President-Manufacturing

All directors hold office until the next annual meeting of the shareholders and the election and qualification of their successors, or until they resign or are removed. All the current directors were elected to their positions in 1984. Officers are elected annually and serve at the pleasure of the Board of Directors.

Jack Tramiel founded the Company in May 1984. Until January 1984, he was President and Chief Executive Officer of Commodore International Limited, which he founded in 1958 under the name Commodore Business Machines Ltd. for the manufacture of typewriters. Mr. Tramiel is the father of Sam, Leonard, and Garry Tramiel.

Sam Tramiel has been the President, Chief Operating Officer and a director of the Company since June 1984. From 1974 until joining the Company, Sam Tramiel was employed by Commodore International Limited, most recently as Vice President-Japan and General Manager-Asia. In that capacity, he was responsible for worldwide computer production, purchasing and semiconductor packaging throughout Asia. From 1976 to 1977 he served as head of Commodore's Consumer Division from Toronto and as General Manager in Hong Kong, London and Santa Clara. In the period 1979 to 1981, Mr. Tramiel was also engaged in the operation of his own OEM manufacturing businesses in the Far East.

Samuel W.L. Chin joined the Company as its Vice President, Chief Financial Officer and Treasurer, and was elected as a director of the Company, in June 1984. He became the General Manager of Atari Taiwan Manufacturing Corporation in February 1985. From 1980 until 1984, Mr. Chin was employed by Commodore International Limited as its Director of Taxes and its Vice President-Finance, Commodore Electronics, Ltd.

Leonard I. Schreiber has been a director of the Company since its formation and served as a Vice President and Secretary of the Company from its formation through August 1986. He is a partner of Schreiber & McBride, which serves as general counsel to the Company. He has been Mr. Tramiel's personal counsel, and until May 1984 had been counsel to Commodore International Limited, for over 20 years.

Gregory A. Pratt joined the Company in June 1984, as General Manager. In February 1985, Mr. Pratt became the Company's Vice President-Finance and Treasurer. From 1979 until joining the Company, Mr. Pratt was employed by Commodore International Limited in several capacities, including Vice President-Finance and Vice President-Operations. Prior to joining Commodore, Mr. Pratt was employed by Arthur Andersen & Co.

Taro Tokai has been employed as Vice President and General Manager of Atari Japan Corp. since July 1, 1984. From November 1976 until May 1984 he served as Vice President of Commodore Japan Ltd.

Garry Tramiel joined the Company in July 1984 as its Assistant Secretary, Assistant Treasurer and Vice President-Administration. In September 1986, he was elected Secretary of the Company. From March 1982 until July 1984, he was employed as an account executive with Merrill, Lynch, Pierce, Fenner & Smith. Before March 1982, Mr. Tramiel attended college.

Shiraz Shivji joined the Company in May 1984 as its Vice President-Advanced Technologies. From 1979 until 1984, Mr. Shivji was employed by Commodore International Limited as Director of Research and Development. He has also worked in research and development capacities with Friden Mailing Equipment, Bechtel Corporation and Berkeley Scientific Laboratories. Mr. Shivji has over 12 years experience in systems design and software development.

Leonard Tramiel became the Company's Vice President-Software Development in July 1984. During the five year period before joining the Company, Mr. Tramiel attended Columbia University in New York where he received a Ph.D. in Astrophysics.

Michael V. Katz joined the Company in November 1985 as its Vice President-Marketing and Entertainment Electronics. From March 1983 to November 1985, Mr. Katz served as President, Chief Executive Officer and Director of Epyx, Inc., a computer game software developer. From 1979 to 1983, Mr. Katz was Vice President-Marketing for Coleco Industries, Inc.

Thomas Brightman joined the Company in July 1984 as its Vice President-Production Engineering. From August 1982 until July 1984, Mr. Brightman was employed as a design manager for Commodore Business Machines, Inc. From March 1977 to August 1982, Mr. Brightman worked for Texas Instruments, Inc. as an engineering manager.

Joseph Spiteri has been the Company's Vice President-Manufacturing since June 1, 1984. From July 1980 to May 1984, Mr. Spiteri was employed by Commodore Business Machines, Inc. Prior to that time, from June 1978, he was Project Engineer-New Products at Fairchild Functional Test Systems, a subsidiary of Schlumberger, and a production manager for Amdahl Corporation, a mainframe computer manufacturer, from 1976 to 1978.

Compensation

The following table sets forth all cash compensation paid or accrued by the Company for services rendered during the year ended December 31, 1985 to the Company's five most highly compensated executive officers whose aggregate cash compensation exceeded $60,000 and to all executive officers as a group.

Name	Capacity in Which Served	Cash Compensation
Sam Tramiel	President and Chief Operating Officer	$162,500
Samuel W.L. Chin	Vice President and General Manager-Atari Taiwan Manufacturing Corp.	125,000
Gregory A. Pratt	Vice President-Finance, Chief Financial Officer and Treasurer	125,000
Taro Tokai	Vice President	114,874
Thomas Brightman	Vice President-Production Engineering	89,230
All executive officers as a group (12 persons)		$906,795

The Company provides certain executive officers and employees with fringe benefits. With the exception of Mr. Chin, who received a $14,474 rental reimbursement in Taiwan and payment of $10,656 of certain personal expenses, and Mr. Tokai, who received a $8,824 rental reimbursement, management

believes that these benefits, valued at their incremental cost to the Company, do not exceed 10% of reported cash compensation for any individual, and with respect to all executive officers as a group, do not exceed 10% of the cash compensation for the group in the foregoing table.

The Company has no pension or retirement plans.

Stock Option Plan

The Company has adopted a 1986 Stock Option Plan (the "Plan").

Under the Plan, key employees, directors and consultants of the Company and its subsidiaries may be granted options to purchase shares of Common Stock. The Plan provides for the issuance of options to purchase up to 1,000,000 shares to such persons and on such terms and conditions as the Board of Directors may determine. Both incentive stock options (as defined by the Internal Revenue Code of 1954, as amended) and non-qualified stock options may be granted pursuant to the Plan. In either case, the exercise price may be not less than 100% of the fair market value of the Common Stock on the date on which the options are granted (in the case of incentive options, 110% of the fair market value if the optionee owns more than 10% of the combined voting power of all classes of stock). No employee may receive, in any calendar year, incentive stock options, the fair market value of which exceeds $100,000 plus any unused limit carryover permitted by Section 422A(c)(4) of the Internal Revenue Code. Incentive stock options are also subject to other requirements provided by law.

Options granted under the Plan have maximum 10-year terms. If the optionee's employment with the Company terminates, the period for exercising any option then held is reduced to a period of 30 days following cessation of employment. If the optionee's employment terminates by reason of death or disability the exercise period is one year. The Plan also provides for acceleration of the right to exercise options at the discretion of the Board of Directors or on the occurrence of certain events, including the merger, consolidation, reorganization, dissolution or liquidation of the Company, or the sale of all or substantially all of the assets of the Company, unless the obligations under the options are assumed by, or such options are replaced by, the successor entity. Options that expire or are cancelled may be used for future options.

The Board of Directors has the power to amend or modify the Plan, provided that no such amendment or modification may be made which adversely affects rights and obligations of options then outstanding without the consent of the affected optionee.

At September 15, 1986, options to purchase 16,000 shares of Common Stock had been granted under the Plan at an average exercise price of $5.25. In 1985, the Company granted certain employees rights to purchase a total of 39,000 shares of Common Stock at $6.00 per share. The Company intends to exchange these rights during 1986 for incentive stock options to purchase Common Stock at fair market value on the date of exchange. At that time, the Company intends to pay these employees the excess, if any, between the fair market value of the stock and $6.00 per share. No such options or rights were granted to any executive officers or directors.

Certain Transactions

Since May 17, 1984, Jack Tramiel has made several loans to the Company in an aggregate principal amount of $12,304,524, at a 12% per annum interest rate. As of June 30, 1986, all of these loans had been repaid.

In November 1984, the Company entered into a Research and Development Agreement with Jack Tramiel pursuant to which Mr. Tramiel partially funded development of the ST series computers. Mr. Tramiel's investment was $500,000. On February 28, 1986, the Company exercised its option under the Agreement to purchase Mr. Tramiel's interest in the ST technology for $575,000.

Under an agreement dated January 22, 1986 with Tandon Corporation for the purchase of disk drives, the Company issued $3,780,680 aggregate principal amount promissory notes to Tandon Corporation. The notes do not bear interest and are payable monthly, through July 15, 1987. Mr. Tramiel has purchased these notes from Tandon Corporation at a 12% discount. As of September 15, 1986, $2,714,360 had been paid to Mr. Tramiel under the notes.

The law firm of Schreiber & McBride, of which Leonard I. Schreiber, a director of the Company, is a partner, provides legal services to the Company. During 1984, 1985 and through September 15, 1986, the Company paid to Schreiber & McBride $50,746, $150,198 and $194,942 of fees and disbursements, respectively.

In September 1984, the Company sold certain accounts receivable to WCI for $10,100,000. See "Business — The WCI Transaction" and Notes 2, 5 and 9 to the Financial Statements for information regarding other Company's transactions and relationships with WCI.

PRINCIPAL SHAREHOLDERS

The following table sets forth, as of September 15, 1986, certain information regarding the ownership of the Common Stock of the Company by (i) each person who is known by the Company to own beneficially more than 5% of the Common Stock, (ii) each director of the Company, and (iii) all directors and executive officers of the Company as a group.

Name and Address(1)	Number of Shares Beneficially Owned	Percent of Outstanding Shares Beneficially Owned	
		Before Offering	After Offering
Directors and 5% shareholders(2):			
Warner Communications, Inc.(3)	7,100,000	29.88%	25.12%
Jack Tramiel(4)	12,753,815	53.67	45.13
Sam Tramiel	563,067	2.37	1.99
Samuel W.L. Chin	125,000(5)	*	*
Leonard I. Schreiber(6)	110,000	*	*
All directors and executive officers as a group (12 persons)	15,411,913	64.86%	54.53%

* Less than 1%.

(1) The address for all directors and shareholders except WCI is c/o Atari Corporation, 1196 Borregas Avenue, Sunnyvale, CA 94088-3427. The address of WCI is 75 Rockefeller Plaza, New York, NY 10019.

(2) For information as to those shareholders who are officers or directors of the Company, see "Management — Directors and Executive Officers."

(3) The foregoing table reflects shares of Common Stock to be issued to WCI concurrently with consummation of this offering. See "Business — The WCI Transaction" and Notes 2, 5 and 9 to the Financial Statements.

(4) By reason of his position with the Company and his beneficial ownership of Common Stock, Mr. Tramiel may be deemed to be a "parent" of the Company within the meaning of the Securities Act of 1933, as amended. The number of shares indicated in the table as beneficially owned by Mr. Tramiel excludes an aggregate of 1,886,162 shares held by his sons, Sam, Leonard and Garry Tramiel, and an aggregate of 339,346 shares held by 12 other family members, as to which Mr. Tramiel disclaims beneficial ownership.

(5) A portion of these shares may be purchased by the Underwriters in the event the Underwriters' over-allotment option is exercised. See "Contingent Selling Shareholders" and "Underwriting."

(6) Does not include 15,000 shares owned by Ellen W. McBride and Laurie L. Fernald, daughters of Mr. Schreiber, as to which Mr. Schreiber disclaims beneficial ownership.

The Contingent Selling Shareholders

The Contingent Selling Shareholders named below have granted the Underwriters an option, exercisable during the 30-day period after the date of this Prospectus, to purchase up to the number of shares

of Common Stock indicated after their names, at the same price per share as the Company will receive for the 4,500,000 shares being purchased by the Underwriters. The Company has concurrently granted the Underwriters an option covering 582,500 shares of Common Stock. The Underwriters may exercise the option only to cover over-allotments. See "Underwriting."

The following table sets forth, as of the date of this Prospectus, the number of outstanding shares of Common Stock owned by the Contingent Selling Shareholders, the number of such shares subject to the Underwriters' over-allotment option, and the number of shares to be held by the Contingent Selling Shareholders assuming the Underwriters' over-allotment option is exercised to the extent of all of the Contingent Shareholders' shares subject to the option.

Name(1)	Shares Beneficially Owned Before Offering	Shares Subject to Over-allotment Option	Shares Beneficially Owned Assuming Option Exercise
Garry Tramiel	754,047	25,000	729,047
Sigmund Hartmann	125,000	12,500	112,500
Gregory A. Pratt	125,000	12,500	112,500
Sam W. L. Chin	125,000	12,500	112,500
David Harris	125,000	12,500	112,500
Taro Tokai	125,000	12,500	112,500
Thomas Brightman	50,000	5,000	45,000

(1) The persons named in the table have sole voting and investment power with respect to all shares of Common Stock shown as being beneficially owned by them. The address of each such person is c/o Atari Corporation, 1196 Borregas Avenue, Sunnyvale, California 94088-3427. Except Garry Tramiel, who owns 2.67% of the outstanding shares of Common Stock after the offering and will own 2.52% assuming the Underwriters' over-allotment option is exercised in full, the percentage of the outstanding shares of Common Stock owned by each such person is less than 1% before and after the offering, regardless of whether the over-allotment option is exercised. Messrs. Tramiel, Pratt, Chin, Tokai and Brightman are executive officers of the Company. See "Management — Directors and Executive Officers." Messrs. Hartmann and Harris have been Vice Presidents of the Company's U.S. subsidiary since November 1984.

Shares Eligible for Future Sale

Upon completion of this offering, the Company will have 28,262,350 shares of Common Stock outstanding. Of these shares, the Common Stock sold in this offering will be freely transferable without restriction or further registration under the Act, except for any shares purchased by an "affiliate" of the Company, as defined under the Act, which will be subject to the resale limitations of Rule 144 adopted under the Act.

The remaining shares of Common Stock outstanding are "restricted" securities within the meaning of Rule 144 (the "Restricted Shares"). The Restricted Shares may not be sold without registration under the Act, except pursuant to an applicable exemption or in reliance upon Rule 144 promulgated under the Act. In general, under Rule 144 as currently in effect, a person (or persons whose shares must be aggregated under Rule 144) who has beneficially owned Restricted Shares for at least two years, including affiliates of the Company, may sell within any three-month period a number of shares that does not exceed the greater of 1% of the then outstanding shares of the Company's Common Stock (approximately 282,624 shares immediately after this offering) or the average weekly trading volume of the Company's Common Stock during the four calendar weeks preceding the filing of the required notice of such sale. Sales under Rule 144 also are subject to certain manner-of-sale restrictions, notice requirements and the availability of current public information about the Company. However, a person who is not deemed to have been an affiliate of the Company at any time during the three months preceding a sale, and who has beneficially owned his or her Restricted Shares for at least three years, would be entitled to sell such shares under Rule 144 without regard to the restrictions described above.

Commencing 90 days after completion of this offering, approximately 489,143 Restricted Shares (which includes 92,500 shares covered by the Underwriters' over-allotment option, which may be sold pursuant to Rule 144, if not purchased by the Underwriters) will be available for sale, from time to time, in the public securities market subject to the restrictions of Rule 144. The Company, Jack Tramiel, WCI and other holders of 25,000 or more shares of Common Stock have agreed that, except as contemplated by this Prospectus, they will not offer, sell or grant any options to purchase or otherwise dispose of any shares of Common Stock owned by them (whether in the public market or by privately negotiated transactions) for a period of 180 days after the date of this Prospectus without the prior written consent of the Representative of the Underwriters. Accordingly, commencing 180 days after the completion of this offering, an additional 21,133,057 Restricted Shares will be eligible for sale from time to time in accordance with the restrictions of Rule 144.

In addition, WCI holds demand registration rights that would permit it to require that Restricted Shares it received in the WCI Transaction be registered under the Act for public sale once each year on up to five occasions. Pursuant to these rights, for six months commencing 180 days after the consummation of this offering, WCI's right to require that the Company register its Restricted Shares may be restricted in the discretion of the managing Underwriter. During the second year following consummation of this offering, WCI could require registration of up to 3.55 million Restricted Shares, and after such two year period, WCI has the right to require registration of Restricted Shares without limitation. WCI also holds certain "piggyback" registration rights that entitle WCI to register its shares concurrently with certain future registrations of additional securities for sale by the Company.

Prior to this offering there has been no public market for the Common Stock of the Company, and no prediction can be made as to the effect, if any, that sales in the public market of Restricted Shares or the availability of Restricted Shares for sale will have on the market price prevailing from time to time. Nevertheless, sales of substantial amounts of Restricted Shares in the public market could adversely affect prevailing market prices.

DESCRIPTION OF CAPITAL STOCK

Common Stock

The Company is authorized to issue up to 100,000,000 shares of Common Stock, $.01 par value per share, of which 28,262,350 shares will be outstanding at the conclusion of this offering.

The holders of Common Stock are entitled to one vote for each share held of record on each matter submitted to a vote of shareholders. Shareholders are not entitled to cumulate their votes in the election of directors of the Company. Meetings of shareholders may be called upon written notice not less than 10 or more than 60 days prior to the date of such meeting. Shareholders holding at least a majority of the voting power may also act by written consent on any matter, except shareholder election of directors, which may only be acted upon at a meeting. Holders of Common Stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors out of funds legally available for dividend distribution after payment of dividends, if any, required to be paid on any Preferred Stock then outstanding. In the event of the liquidation, dissolution or winding up of the Company, holders of Common Stock are entitled to share equally and ratably in all assets, if any, remaining after payment of all liabilities and liquidation rights, if any, of the Preferred Stock then outstanding. The Company has never paid cash dividends on its Common Stock and does not anticipate paying any in the foreseeable future. See "Dividend Policy." Holders of Common Stock have no preemptive rights or rights to subscribe to additional securities of the Company. The Common Stock is neither redeemable nor convertible into any other securities, and there are no sinking fund provisions. The outstanding Common Stock is, and the Common Stock to be outstanding upon completion of this offering will be, fully paid and nonassessable.

As of September 15, 1986, there were 109 holders of record of the Common Stock.

By reason of his position as an officer and director of the Company and his beneficial ownership of Common Stock, Jack Tramiel may be deemed to be a "parent" of the Company within the meaning of the

Securities Act of 1933, as amended. Based upon the number of shares to be outstanding after completion of the offering and the percentage of such shares to be owned by Mr. Tramiel and his family (53% assuming no exercise of the Underwriters' over-allotment option), Mr. Tramiel and his sons will continue to be able to elect a majority of the Board of Directors and to authorize and control most corporate actions.

Preferred Stock

The Company is also authorized to issue up to 10,000,000 shares of Preferred Stock, $.01 par value per share. The Board of Directors is empowered, without further action by the stockholders, to issue from time to time one or more series of Preferred Stock (up to an aggregate of 10,000,000 shares), to fix the dividend rights, dividend rate, conversion rights, right and terms of redemption (including sinking fund provisions), redemption prices, liquidation preferences, voting rights and other terms of any wholly unissued series of Preferred Stock and to determine the designation of and (subject to the aggregate limit of 10,000,000 shares) the number of shares constituting any such unissued series. The Company has no current plans to issue Preferred Stock.

Transfer Agent and Registrar

The Registrar and Transfer Company is the transfer agent and registrar of the Common Stock.

UNDERWRITING

The Underwriters named below, for whom PaineWebber Incorporated is acting as Representative, have severally agreed, subject to the terms and conditions of the Underwriting Agreement, to purchase from the Company, and the Company has agreed to sell to the Underwriters, the number of shares of Common Stock set forth opposite their respective names below:

Underwriter	Number of Shares
PaineWebber Incorporated	
Total	4,500,000

The Underwriting Agreement provides that the obligations of the Underwriters to purchase the shares of Common Stock are subject to certain conditions. The Underwriters are committed to purchase, and the Company is obligated to sell, all the shares of Common Stock offered by this Prospectus if any are purchased.

The Company has been advised by the Representative that the Underwriters propose to offer the shares of Common Stock to the public at the initial public offering price set forth on the cover page of this Prospectus, and to certain securities dealers at such price less a concession not in excess of $ per share. The Underwriters may allow, and such dealers may reallow, concessions of not more than $ per share to certain other dealers. After the initial public offering, the public offering price and concessions may be changed by the Representative.

The Underwriters have obtained an option from the Company and the Contingent Selling Shareholders, exercisable during the 30-day period after the date of this Prospectus, under which they may purchase up to 582,500 additional shares of Common Stock from the Company and 92,500 additional shares of Common Stock from the Contingent Selling Shareholders at the same price per share as the Company will receive for the 4,500,000 shares being purchased by the Underwriters. See "Principal Shareholders — Contingent Selling Shareholders."

The Underwriters may exercise the option only to cover over-allotments. In the event the Underwriters exercise the option, each Underwriter will be obligated, subject to certain conditions, to purchase the number of additional shares of Common Stock as to which the option is exercised proportionate to such Underwriter's initial commitment. The Company and the Contingent Selling Shareholders have agreed with the Underwriters that, in the event the option is exercised, the Underwriters will purchase first the shares held by the Contingent Selling Shareholders subject to the option, in proportion to the number of shares subject to the option. Any additional shares as to which the option is exercised will be purchased from the Company.

The Company and the Contingent Selling Shareholders have agreed to indemnify the Underwriters and their controlling persons against certain liabilities under the Act or to contribute to payments the Underwriters may be required to make in respect of such liabilities.

The Representative has informed the Company that it does not expect the Underwriters to confirm sales of shares of Common Stock offered by this Prospectus to discretionary accounts.

The Company and its shareholders holding more than 25,000 shares of Common Stock have agreed not to offer or sell any shares of Common Stock for a period of 180 days after the date of this Prospectus without the prior written consent of the Representative; provided, however, that beginning 90 days after the date of this Prospectus each Contingent Selling Shareholder is entitled to sell, without the Representative's prior written consent but subject to the restrictions, if applicable, of Rule 144 under the Act, the number of such Contingent Selling Shareholder's shares subject to the over-allotment option which are not purchased by the Underwriters upon any exercise of the option.

Prior to this offering there has been no public market for the Common Stock of the Company. The initial public offering price of the shares covered by this Prospectus has been determined by negotiation between the Company and the Representative of the Underwriters. Among the factors considered in determining the public offering price were the Company's operating results in recent periods, estimates of its business prospects, an assessment of management, the general condition of the securities markets, prevailing market and general economic conditions, and recent price-earnings ratios and market prices of securities of comparable companies.

LEGAL MATTERS

Certain legal matters relating to the shares of Common Stock offered by this Prospectus will be passed upon for the Company by Gibson, Dunn & Crutcher, One Almaden Boulevard, Suite 1000, San Jose, California 95113 and for the Underwriters by Cravath, Swaine & Moore, One Chase Manhattan Plaza, New York, New York 10005.

EXPERTS

The consolidated financial statements as of December 31, 1984 and 1985 and June 30, 1986 and for the period from May 17, 1984 (inception) to December 31, 1984, the year ended December 31, 1985 and the six months ended June 30, 1986 included in this Prospectus and the related supplemental schedules included elsewhere in the Registration Statement have been examined by Deloitte Haskins & Sells, independent public accountants, as stated in their opinions appearing herein and elsewhere in this Registration Statement, and have been so included in reliance upon such opinions given upon the authority of that firm as experts in accounting and auditing. In addition, the historical selected financial data for the periods stated above, appearing on page 10, has been derived from amounts in the consolidated financial statements examined by Deloitte Haskins & Sells as stated in their opinion appearing in this Prospectus.

ADDITIONAL INFORMATION

The Company has filed a Registration Statement with the Securities and Exchange Commission, Washington, D.C. in accordance with the provisions of the Securities Act of 1933. This Prospectus does not contain all of the information set forth in the Registration Statement, certain portions of which have been omitted as permitted by the Rules and Regulations of the Commission. For further information pertaining to the Common Stock offered by this Prospectus and to the Company, reference is made to the Registration Statement, including the exhibits filed as a part thereof. Statements in this Prospectus concerning the provisions of any document are not necessarily complete and, in each instance, reference is made to the copy of such document filed as an exhibit to the Registration Statement. Each such statement is qualified in its entirety by such reference. The Registration Statement may be obtained from the Securities and Exchange Commission upon payment of the prescribed fees and may be examined at the principal office of the Commission in Washington, D.C.

OPINION OF INDEPENDENT PUBLIC ACCOUNTANTS

Atari Corporation:

We have examined the consolidated balance sheets of Atari Corporation and subsidiaries as of December 31, 1984 and 1985 and June 30, 1986 and the related consolidated statements of operations, shareholders' equity and changes in financial position for the period from May 17, 1984 (inception) to December 31, 1984, the year ended December 31, 1985 and the six months ended June 30, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such consolidated financial statements present fairly the financial position of the companies at December 31, 1984 and 1985 and June 30, 1986 and the results of their operations and the changes in their financial position for the periods stated above, in conformity with generally accepted accounting principles applied on a consistent basis. Also, in our opinion, the historical information set forth in the selected financial data for the periods stated above, appearing on page 10, is fairly stated in all material respects in relation to the consolidated financial statements from which it has been derived.

DELOITTE HASKINS & SELLS

San Jose, California
September 15, 1986

ATARI CORPORATION

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 1984	December 31, 1985	June 30, 1986
	(dollars in thousands)		
CURRENT ASSETS:			
Cash and temporary cash investments (including restricted cash held in escrow fund (see Note 2): 1985, $9,986; 1986, $6,140)	$ 20,752	$ 26,414	$ 29,402
Warrants to purchase WCI common stock (Note 2)	4,000	—	—
Trade receivables (less allowance: $3,701, $2,704, $2,770)	55,845	22,241	19,333
Inventories (Notes 2 and 3)	84,843	77,181	72,169
Prepaid expenses and supplies	1,073	682	1,338
Total current assets	166,513	126,518	122,242
PROPERTY — Net (Notes 2 and 4)	12,250	6,803	6,139
OTHER ASSETS	6,500	5,723	5,907
TOTAL	$185,263	$139,044	$134,288

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:			
Current maturities of long-term obligations	$ 1,788	$ 13,330	$ 4,716
Accounts payable	86,536	55,985	48,289
Income taxes payable	—	—	2,802
Deferred revenue	3,013	619	435
Accrued liabilities (Note 7)	61,356	44,835	26,268
Total current liabilities	152,693	114,769	82,510
LONG-TERM OBLIGATIONS (Note 5)	39,469	43,752	60,262
COMMITMENTS (Note 6) AND CONTINGENT LIABILITIES (Note 12)			
SHAREHOLDERS' EQUITY (Note 9):			
Preferred stock, $.01 par value — authorized 10,000,000 shares; none outstanding	—	—	—
Common stock, $.01 par value — authorized, 100,000,000 shares; outstanding: 1984, 15,035,000 shares; 1985, 16,341,350 shares; 1986, 16,587,600 shares	150	163	166
WCI stock right (Note 2)	27,500	27,500	27,500
Additional paid-in capital	29,920	32,596	33,188
Notes receivable from sale of common stock	(1,257)	(1,642)	(1,921)
Accumulated deficit	(62,758)	(77,072)	(64,672)
Accumulated translation adjustments	(454)	(1,022)	(2,745)
Total shareholders' equity (deficiency)	(6,899)	(19,477)	(8,484)
TOTAL	$185,263	$139,044	$134,288

See notes to consolidated financial statements.

ATARI CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	May 17, 1984 (inception) to December 31, 1984	Year Ended December 31, 1985	Six Months Ended June 30, 1985	Six Months Ended June 30, 1986
			(unaudited)	
	(in thousands, except per share data)			
NET SALES:				
New and redesigned products	$ 16,115	$ 47,817	$ 6,766	$ 89,069
Purchased products (Note 2)	94,565	94,170	40,886	16,517
Total	110,680	141,987	47,652	105,586
COSTS AND EXPENSES:				
Cost of sales:				
New and redesigned products	9,476	28,666	4,355	49,284
Purchased products	129,050	100,133	49,089	16,029
Liquidation and transition costs (Note 2)	13,131	4,966	4,966	—
Research and development	3,451	9,452	4,569	6,216
Marketing and distribution	10,630	17,536	7,544	11,957
General and administrative	6,397	7,053	3,465	5,221
Total	172,135	167,806	73,988	88,707
OPERATING INCOME (LOSS)	(61,455)	(25,819)	(26,336)	16,879
Other income — net	1,883	19,904	3,750	2,385
Interest income	1,824	741	351	872
Interest expense	(5,010)	(9,140)	(4,440)	(4,934)
Income (loss) before income taxes and extraordinary credit	(62,758)	(14,314)	(26,675)	15,202
Provision for income taxes	—	—	—	6,735
Income (loss) before extraordinary credit	(62,758)	(14,314)	(26,675)	8,467
Extraordinary credit — tax reduction from use of net operating loss carryforwards	—	—	—	3,933
NET INCOME (LOSS)	$(62,758)	$(14,314)	$(26,675)	$ 12,400
EARNINGS (LOSS) PER COMMON AND EQUIVALENT SHARE (Note 1):				
Income (loss) before extraordinary credit	$ (2.78)	$ (.62)	$ (1.18)	$ .38
Net income (loss)	$ (2.78)	$ (.62)	$ (1.18)	$ .56
Number of shares used in the computation	22,554	23,033	22,593	23,762

See notes to consolidated financial statements.

ATARI CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Period from May 17, 1984 (Inception) Through June 30, 1986

	Common Stock Shares	Common Stock Amount	WCI Stock Right	Additional Paid-in Capital	Notes Receivable from Sale of Common Stock	Accumulated Deficit	Accumulated Translation Adjustments	Total
				(amounts in thousands)				
Common stock sold	16,142	$161		$32,122	$(1,372)			$ 30,911
Stock right issued to WCI for net assets acquired			$27,500					27,500
Common stock repurchased	(1,107)	(11)		(2,202)				(2,213)
Payments on notes receivable					115			115
Translation adjustments							$ (454)	(454)
Net loss						$(62,758)		(62,758)
BALANCES, DECEMBER 31, 1984	15,035	150	27,500	29,920	(1,257)	(62,758)	(454)	(6,899)
Common stock sold	1,416	14		2,395	(568)			2,341
Common stock repurchased	(110)	(1)		(219)	33			(187)
Payments on notes receivable					150			150
Translation adjustments							(568)	(568)
Net loss						(14,314)		(14,314)
BALANCES, DECEMBER 31, 1985	16,341	163	27,500	32,596	(1,642)	(77,072)	(1,022)	(19,477)
Common stock sold	254	3		611	(614)			—
Common stock repurchased	(7)	—		(19)	19			—
Payments on notes receivable					316			316
Translation adjustments							(1,723)	(1,723)
Net income						12,400		12,400
BALANCES, JUNE 30, 1986	16,588	$166	$27,500	$33,188	$(1,921)	$(64,672)	$(2,745)	$ (8,484)

See notes to consolidated financial statements.

ATARI CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	May 17, 1984 (inception) to December 31, 1984	Year Ended December 31, 1985	Six Months Ended June 30, 1985	Six Months Ended June 30, 1986
			(unaudited)	
		(in thousands)		
FUNDS PROVIDED FROM:				
Operations:				
Income (loss) before extraordinary credit	$(62,758)	$(14,314)	$(26,675)	$ 8,467
Depreciation and amortization not requiring working capital	752	2,516	987	1,076
Total provided from (used by) operations	(62,006)	(11,798)	(25,688)	9,543
Extraordinary credit				3,933
Common stock sold — net	28,813	2,304		316
Net assets acquired from WCI for:				
Stock right	27,500			
Long-term obligation	24,665			
Working capital included in net assets acquired from WCI	44,952			
Disposal of property	911	6,068	2,071	2,384
Additions to long-term obligations	1,752	4,283	2,117	16,510
Total	66,587	857	(21,500)	32,686
FUNDS USED FOR:				
Net assets acquired from WCI	52,165			
Property purchases	148	1,906	874	1,958
Effect of exchange rate changes on working capital	454	1,022	287	2,745
Total	52,767	2,928	1,161	4,703
INCREASE (DECREASE) IN WORKING CAPITAL	$ 13,820	$ (2,071)	$(22,661)	$27,983
INCREASE (DECREASE) IN WORKING CAPITAL BY COMPONENT:				
Cash and temporary cash investments	$ 20,752	$ 5,662	$(15,482)	$ 2,988
Warrants	4,000	(4,000)	—	—
Receivables	55,845	(33,604)	(28,058)	(2,908)
Inventories	84,843	(7,662)	(12,800)	(5,012)
Prepaid expenses and supplies	1,073	(391)	807	656
Current maturities of long-term debt	(1,788)	(11,542)	(7,210)	8,614
Accounts payable	(86,536)	30,551	25,459	7,696
Income taxes payable	—	—	—	(2,802)
Deferred revenue	(3,013)	2,394	376	184
Accrued liabilities	(6,356)	16,521	14,247	18,567
INCREASE (DECREASE) IN WORKING CAPITAL	$ 13,820	$ (2,071)	$(22,661)	$27,983

See notes to consolidated financial statements.

ATARI CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization — The Company (formerly Tramel Technology, Ltd.) was formed on May 17, 1984 to design, manufacture, sell and service personal computers and related software and peripheral products. The principal methods of distribution are through computer specialty dealers and mass market retailers.

Principles of consolidation — The consolidated financial statements include the Company and its subsidiaries. All transactions and balances between the companies are eliminated.

Inventories are stated at the lower of cost or market. Cost of manufactured products is computed using standard costs which approximate cost on a first-in, first-out basis.

Property is stated at cost (see Note 2). Depreciation is computed using the straight-line method based on estimated useful lives of the assets of 2 to 27 years. Leases and leasehold improvements are amortized over the estimated useful life or lease term, as appropriate.

Revenue recognition — Sales are recognized upon shipment.

Research and development expenditures are expensed as incurred.

Income taxes — Deferred taxes are provided for timing differences between pretax accounting income and taxable income and relate primarily to depreciation and amortization and certain accruals. Investment tax credits reduce the provision for income taxes when realizable.

Provisions are made for estimated United States and foreign taxes which may be incurred on remittance of undistributed earnings of the Company's subsidiaries. Possible taxes beyond those provided would not be material.

Foreign currency translation — Assets and liabilities of operations outside the United States, except for operations that are highly integrated with operations of the Company (principally in Taiwan), are translated into United States dollars using current exchange rates, and the effects of foreign currency translation adjustments are deferred and included as a component of shareholders' equity. For operations that are highly integrated, foreign currency translation adjustments are included in operations. Exchange and translation gains (losses) included in operations for the period ended December 31, 1984, the year ended December 31, 1985 and the six months ended June 30, 1986 were $(764,000), $1,884,000 and $1,478,000, respectively.

Earnings (loss) per common and equivalent share — Net income per share is computed based on the weighted average number of common and equivalent shares outstanding during the period. Net loss per share is computed based on the weighted average number of shares of common stock outstanding and excludes common stock equivalents as they would be anti-dilutive. Common stock issuable to WCI upon completion of this offering (7,100,000 shares, see Note 2) has been treated as outstanding for all periods in calculating net income (loss) per common and equivalent share because such shares will have been issued at prices substantially below the proposed public offering price. Interest expense of $922,000, or $.04 per share ($498,000 net of income taxes, or $.02 per share) related to the 10.5% notes due WCI (see Notes 2 and 5) has been added to net income and income before extraordinary credit, respectively, in calculating earnings per share for the six months ended June 30, 1986.

Unaudited financial statements — Information with respect to the six months ended June 30, 1985 is unaudited. In the opinion of management, such information contains all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the results for such periods.

2. ACQUISITION AND WCI TRANSACTIONS

Effective July 2, 1984, Atari Corporation acquired certain assets from and assumed certain liabilities of certain associated entities of Warner Communications, Inc.'s (collectively referred to as "WCI") Atari home computer and home video game product lines and received warrants (valued at $4,000,000) to buy

1,000,000 shares of Warner Communications, Inc. common stock at $22 per share through July 1, 1989 (the "WCI warrants"). Pursuant to the assets purchase agreement, the Company's securities given in exchange for those net assets were subject to adjustment based upon the Company's and WCI's subsequent evaluation of the nature and extent of the assets acquired and the liabilities assumed by the Company. In August 1986, the Company and WCI completed such evaluation and agreed upon the adjusted consideration for the net assets acquired. Such consideration consists of a $24.7 million obligation due in June 1994 and a stock right (valued at $27.5 million) which is convertible into 3,550,000 shares of common stock (see Note 9). The obligation is stated at the principal balance plus accrued interest at 17% from July 2, 1984. This acquisition was accounted for as a purchase.

The fair value assigned to assets acquired and liabilities assumed were as follows (in thousands):

Warrants	$ 4,000
Accounts receivable	44,911
Inventories	135,371
Property	14,921
Other assets	9,840
Current liabilities	(143,326)
Other long-term liabilities	(13,552)
	$ 52,165

In November 1985, WCI repurchased the WCI warrants for $15 million, of which $13.9 million was placed in escrow and restricted to cover certain claims and pending actions against the Company arising from the product lines acquired from WCI (see Note 12). The gain of $11,000,000 from sale of the WCI warrants is included in other income in 1985.

As part of the acquisition agreement, WCI agreed to loan to the Company up to $25 million at 10.5% to pay down liabilities assumed. At June 30, 1986, the Company had borrowed approximately $24.7 million (see Note 5). If a public offering (such as the one contemplated by this Prospectus) is completed before August 18, 1987, these notes plus accrued interest will be automatically converted into an additional 3,550,000 shares of common stock. If such an offering is not completed before August 18, 1987, WCI has the option to convert $15 million of such notes plus accrued interest into 3,550,000 shares of common stock.

In connection with this acquisition, the Company obtained certain products which were not consistent with its long-range business strategy. Accordingly, the Company instituted a plan to liquidate the inventory and a portion of the manufacturing and distribution facilities acquired; the related product sales and costs are classified as purchased products in the consolidated statements of operations. In addition, certain employment and occupancy costs incurred by the Company in the liquidation of the assets acquired have been classified as liquidation and transition costs in the consolidated statements of operations.

In September 1984, the Company sold certain accounts receivable to WCI for $10,100,000.

3. INVENTORIES

Inventories consist of the following:

	December 31,		June 30,
	1984	1985	1986
		(in thousands)	
Raw materials and work-in-process	$44,302	$21,093	$23,320
Finished goods	40,541	56,088	48,849
Total	$84,843	$77,181	$72,169

At June 30, 1986, remaining inventories purchased from WCI (see Note 2) were approximately $22,591,000.

4. PROPERTY

Property consists of:

	December 31, 1984	December 31, 1985	June 30, 1986
		(in thousands)	
Land	$ 2,526	$2,526	$ 2,526
Buildings	1,825	1,825	1,825
Machinery and equipment	7,436	4,732	3,772
Furniture and fixtures	1,012	538	714
Leasehold improvements	3	69	177
Total	12,802	9,690	9,014
Accumulated depreciation and amortization	(552)	(2,887)	(2,875)
Property — net	$12,250	$6,803	$ 6,139

5. LONG-TERM OBLIGATIONS

Long-term obligations consist of:

	December 31, 1984	December 31, 1985	June 30, 1986
		(in thousands)	
Obligation due WCI in June 1994 (including accrued interest at 17%, see Note 2)	$26,762	$31,504	$34,182
Notes due WCI in August 1991 (interest at 10.5%, see Note 2)	—	10,367	24,737
Notes due principal shareholder (interest at 12%, see Note 11)	500	8,698	1,840
Other obligations	13,995	5,513	4,219
Total	41,257	57,082	64,978
Current maturities	(1,788)	(13,330)	(4,716)
Long-term obligations	$39,469	$43,752	$60,262

The 17% obligation due WCI in June 1994 is to be paid from the proceeds of the offering contemplated by this Prospectus.

The 10.5% notes due WCI will be automatically converted into 3,550,000 shares of common stock upon completion of the offering contemplated by this Prospectus.

As of June 30, 1986, maturities of long-term obligations (excluding the obligation and notes due WCI) are: 1986 (six months), $3,613,000; 1987, $1,640,000 and 1988, $806,000.

6. COMMITMENTS

The Company leases various facilities and equipment under noncancellable lease arrangements. The major facilities leases are for terms of one to ten years and are accounted for as operating leases. These leases generally provide renewal options of five additional years. Minimum future lease payments under all noncancellable leases as of December 31, 1985 are as follows:

	Operating Leases
	(in thousands)
1986	$ 2,002
1987	1,877
1988	1,738
1989	1,636
1990	1,406
Later years	2,672
Total minimum lease payments	$11,331

Rent expense for all operating leases was $2,428,000, $3,670,000 and $1,242,000 for the period ended December 31, 1984, the year ended December 31, 1985 and the six months ended June 30, 1986, respectively.

7. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	December 31,		June 30,
	1984	1985	1986
	(in thousands)		
Accrued royalties	$19,904	$21,463	$ 5,866
Accrued claims and litigation expense	13,594	9,725	6,132
Accrued customer allowances	19,972	7,497	8,848
Other	7,886	6,150	5,422
Total	$61,356	$44,835	$26,268

8. INCOME TAXES

The provision for income taxes consists of:

	Six Months Ended June 30, 1986
	(in thousands)
Current foreign	$2,802
Charge equal to reduction in income taxes from use of net operating loss carryforward	3,933
Total	$6,735

Income (loss) before income taxes for the period ended December 31, 1984, the year ended December 31, 1985 and the six months ended June 30, 1986 include income (losses) of $(3,493,000), $(12,463,000) and $6,986,000, respectively, from the Company's foreign subsidiaries.

The effective income tax rate for the six months ended June 30, 1986 was 44%. The effective rate differs from the Federal statutory rate of 46% as follows:

	Six Months Ended June 30, 1986 (in thousands)
Computed at 46%	$6,993
Effect of foreign rates less than statutory rate	(2,355)
Effect of foreign losses providing no tax benefit	1,930
Other	167
Provision for income taxes	$6,735

At June 30, 1986, net operating loss carryforwards of $16,800,000 are available for tax purposes to offset future Federal taxable income. For financial reporting purposes, such net operating loss carryforwards total $45,900,000. These carryforwards expire beginning in 1999 through the year 2000.

9. SHAREHOLDERS' EQUITY

All shares and per share amounts have been adjusted to reflect a one-for-two reverse stock split in September 1986.

WCI Stock Right

Significant terms of the WCI stock right are as follows:

If a public offering (such as the one contemplated by this Prospectus) is completed before August 18, 1987, the stock right will be automatically converted into 3,550,000 shares of common stock. If such an offering is not completed before August 18, 1987, the Company will issue 700,000 shares of convertible preferred stock to WCI. Significant terms of this preferred stock would be as follows:

- The preferred stock would be convertible into an aggregate of 3,550,000 shares of common stock (subject to adjustment for events of dilution).
- The preferred stock would have the same voting rights as the common stock into which it is convertible.
- In the event of liquidation or dissolution of the Company, the preferred shareholder would receive $100 per share plus any declared but unpaid dividends prior to any distribution to the common shareholders.
- The preferred stock would participate as to dividends and all other distributions as if it were converted into 3,550,000 shares of common stock.

Common Stock

At June 30, 1986, founders and employees of the Company have purchased 16,587,600 common shares under stock purchase agreements at fair market value as determined by the Board of Directors. The employees' shares generally vest 20% at the end of each of the initial five years of employment. At June 30, 1986, 4,276,000 shares were subject to repurchase.

In 1986, the Company adopted a stock option plan. The plan provides for the issuance of both incentive stock options to employees and non-qualified stock options to employees, directors and consultants. Under the plan, options to purchase up to 1,000,000 shares of common stock may be granted at not less than fair market value as determined by the Board of Directors, become exercisable as established by the Board (generally ratably over 5 years) and expire 10 years from date of grant.

In 1985 the Company granted certain employees rights to purchase a total of 39,000 shares of common stock at $6.00 per share. The Company intends to exchange these rights during 1986 for incentive stock options to purchase common stock at fair market value on the date of exchange. At that time, the Company intends to pay these employees the excess, if any, between the fair market value of the stock and $6.00 per share. At

June 30, 1986, options to purchase 12,000 shares at $5.00 per share had been granted and were exercisable and options for 949,000 shares were available for future grant.

At June 30, 1986, the Company had reserved shares of common stock for issuance as follows:

Conversion of WCI stock right	3,550,000
Conversion of 10.5% notes due WCI	3,550,000
Stock plans	1,000,000
Total	8,100,000

10. SEGMENT INFORMATION

The Company operates in one industry segment — the design, manufacture, sale and servicing of consumer electronic products.

The Company's foreign operations consist of manufacturing facilities in the Far East and distribution facilities in Europe and Canada. Transfers between geographic areas are accounted for at amounts generally above cost. Corporate assets are cash and temporary cash investments. The following table presents a summary of operations by geographic region.

	May 17, 1984 (inception) to December 31, 1984	Year Ended December 31, 1985	Six Months Ended June 30, 1986
	(in thousands)		
Revenues from unaffiliated customers:			
North America:			
Domestic	$ 63,012	$ 56,599	$ 43,278
Export sales	689	33,745	20,297
Europe	45,119	47,213	41,934
Far East	1,860	4,430	77
Total	$110,680	$141,987	$105,586
Transfers from geographic areas (eliminated in consolidation):			
North America	$ 10,928	$ 53,281	$ 27,969
Europe	27,206	32,694	2,389
Far East	132,078	143,332	57,016
Total	$170,212	$229,307	$ 87,374
Operating income (loss):			
North America	$(45,996)	$(10,967)	$ 7,920
Europe	(16,071)	(9,511)	9,864
Far East	612	(5,341)	(905)
Total	$(61,455)	$(25,819)	$ 16,879
Identifiable assets at period end:			
North America	$ 90,454	$ 63,483	$ 59,529
Europe	47,264	27,623	22,372
Far East	22,793	21,524	22,985
Corporate assets	24,752	26,414	29,402
Total	$185,263	$139,044	$134,288

11. RELATED PARTY TRANSACTIONS

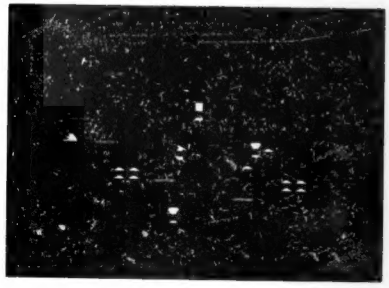
In 1985, the Company entered into an agreement with its principal shareholder which provided the Company with additional working capital. The maximum amounts outstanding under this arrangement for the year ended December 31, 1985, and the six months ended June 30, 1986 were $10,152,000 and $8,623,000, respectively. Interest was charged at 12%. All amounts were repaid as of June 30, 1986.

In November 1984, the Company and its principal shareholder entered into a research and development agreement whereby the Company received $500,000 to develop the ST line of computers. In February 1986, the Company exercised its option under the agreement and acquired the principal shareholder's interest for $575,000.

In 1986 the Company issued promissory notes to a supplier for $3,780,680. The notes are due within one year and do not bear interest. The Company's principal shareholder purchased these notes from the supplier at a 12% discount. At June 30, 1986 $1,840,000 of these notes were outstanding and classified as notes due principal shareholder.

12. CONTINGENT LIABILITIES

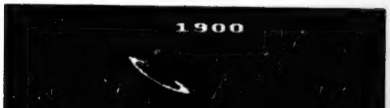
There are various claims and pending actions against the Company with respect to alleged damages in connection with vendor and supplier claims and other matters arising out of the Company's acquisition of certain assets and assumption of certain liabilities of WCI's Atari home computer and home video game product lines. The Company established a $13.9 million escrow fund to satisfy certain of these actions. The amounts of liability on all remaining claims and actions at June 30, 1986 were not determinable but management believes, after consultation with counsel, the ultimate liability resulting therefrom will not materially affect the consolidated financial position of the Company.



Atari line of Video Systems.

2600 Video Game System

7800 Video Game System



No person has been authorized to give any information or to make any representations in connection with this offering other than those contained in this Prospectus and, if given or made, such other information and representations must not be relied upon as having been authorized by the Company or the Underwriters. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information contained herein is correct as of any time subsequent to its date. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the registered securities to which it relates. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful.

TABLE OF CONTENTS

	Page
Prospectus Summary	3
The Company	5
Risk Factors	6
Use of Proceeds	7
Dividend Policy	8
Dilution	8
Capitalization	9
Selected Financial Data	10
Management's Discussion and Analysis of Results of Operations and Financial Condition	11
Business	14
Management	24
Principal Shareholders	27
Description of Capital Stock	29
Underwriting	31
Legal Matters	32
Experts	32
Additional Information	32
Financial Statements	F-1

Until , 1987, all dealers effecting transactions in the securities offered hereby, whether or not participating in this distribution, may be required to deliver a Prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a Prospectus when acting as Underwriters and with respect to their unsold allotments or subscriptions.

4,500,000 Shares

ATARI

ATARI CORPORATION

Common Stock

PROSPECTUS

PaineWebber
Incorporated

, 1986